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Politics this week

Oct 31st 2002
From The Economist print edition

Siege in Moscow

Getty

The siege of a Moscow theatre by **Chechen terrorists** ended when the Russian authorities pumped in gas through the air-conditioning system. By the time troops stormed in, it had killed many of the Chechens—and nearly 120 of the hostages. The operation was a success, said the government, while refusing for days to tell doctors what gas it had used. A security clampdown in Chechnya was ordered.

See article: What can Russia do about Chechnya?

An **EU summit** in Brussels defined the terms for the acceptance of ten new members. The summit was overshadowed by a row between Tony Blair and Jacques Chirac over farm-policy costs and reform. A convention led by Valéry Giscard d'Estaing released a list of headings for Europe's new constitution.

See article: Eurosummitry goes into static mode

Turks prepared to vote in a general election on November 3rd. Pollsters forecast a runaway win for the conservative Justice and Development Party.

See article: Turkey's turning point

The city of **Florence** started boarding up some of its artistic treasures in anticipation of a huge gathering, due to start on November 6th, of the European Social Forum. The meeting is expected to draw anti-globalisation protesters of the sort seen in Seattle, Genoa and elsewhere.

Brazil's victor

Luiz Inacio Lula da Silva of the left-wing Workers' Party (PT) won a run-off ballot for **Brazil's** presidency, with 53m votes (61%), against 33m (39%) for Jose Serra, his centrist opponent. But the PT did poorly in run-offs for state governorships. Mr da Silva named a party moderate to head his transition team.

See article: Brazil's presidential election

Cesar Gaviria, the secretary-general of the Organisation of American States, tried to set up a dialogue between **Venezuela's** government and its opposition. He expressed hope that agreement on an early vote was possible.

See article: No end to Venezuela's stand-off

Uruguay's government lost its coalition partner. The National Party withdrew its five cabinet ministers but, it said, not its Congressional support for Jorge Batlle's administration, which has imposed austerity measures to try to prevent a debt default and banking collapse.

Prime Minister Jean Chrétien's hopes of persuading his country to ratify the Kyoto Protocol on climate change suffered a setback when a meeting of energy and environment ministers from **Canada's** provinces rejected a federal emissions-reduction plan.

See article: Canada wrangles over pollution

Untimely demise

Getty

Senator Paul Wellstone, a passionate Democrat from Minnesota, was killed in a **plane crash** in the state. The Democrats chose Walter Mondale, Jimmy Carter's vice-president, to run in his place.

See article: The effect of Paul Wellstone's death

Michael Bellesiles resigned from Emory University after an independent committee criticised him for “egregious misrepresentation” and “falsification”. His book, “Arming America”, won the Bancroft award for the best work of history in 2000 for arguing (wrongly) that guns were much rarer in American history than previously thought.

Federal and state charges were brought against John Muhammad, the alleged **Washington sniper**. The Justice Department will decide where he will first stands trial—he faces the death penalty in all courts. His 17-year-old companion, John Malvo, has also been charged.

Government of disunity

Israel's 20-month national-unity government collapsed when the Labour Party walked out, led by Binyamin Ben-Eliezer and Shimon Peres, the defence and foreign ministers. Ariel Sharon announced he would try to carry on with a narrow right-wing coalition. If he called an election, his Likud party is far ahead in the polls, but he would be personally challenged by Binyamin Netanyahu, a former right-wing prime minister.

See article: Israel's government collapses

The Palestinian parliament approved **Yasser Arafat's** new cabinet, though reformers were disappointed by the modesty of the changes. The cabinet is due to serve only until January 20th 2003, which is when Mr Arafat has scheduled presidential and legislative elections.

An Israeli woman and two girls were killed by a **Palestinian attacker** who crawled under the fence surrounding their settlement in the northern West Bank. Earlier, a Palestinian suicide bomber killed three Israeli soldiers at another settlement.

See article: Israeli settlement in the West Bank

A black township in **South Africa** was hit by nine explosions, killing at least one person. Another bomb hit a Buddhist temple near Pretoria, the capital. President Thabo Mbeki blamed the attacks on white racists.

Eight **Algerians**, including four children, were killed by suspected Islamist rebels in the north-west of the country.

Rebels seized part of Bangui, the capital of the **Central African Republic**. Government troops, aided by Libyan warplanes, forced them out.

See article: Rebellion in Central Africa

Congo's government and two main rebel groups reached an agreement in principle on power-sharing. Observers hope the deal will pave the way for the country's first democratic elections, but fighting continued in the east.

Sketchy evidence

Indonesian police issued sketches of three men they want to question in connection with the bombing of **Bali's nightlife district**, in which at least 184 people died, mostly foreign tourists. Many of Bali's 800 hotels are said to be almost empty.

At least 60 people died in a fire in an office building in Ho Chi Minh City, the worst in **Vietnam's** second city for more than 20 years. An electrical fault was blamed.

North Korea turned down a demand by Japan to scrap its nuclear-arms programme but said that it was prepared to discuss the matter with the United States.

See article: North Korea's nuclear ambitions

A bomb exploded outside a hotel in Pattani in southern **Thailand**, the latest in a series of attacks in a largely Muslim region. Britain said threats to westerners in Thailand's resort island of Phuket had increased sharply.

Reuters

Afghanistan's president, Hamid Karzai, said he plans to send a team to the United States military prison at Guantanamo Bay in Cuba to seek the release of Afghans there. He also spoke out against the resurgence of warlordism among his resigned leaders: “We gave them a chance to bring peace and Islam to the country, but now I see the same old behaviour.”

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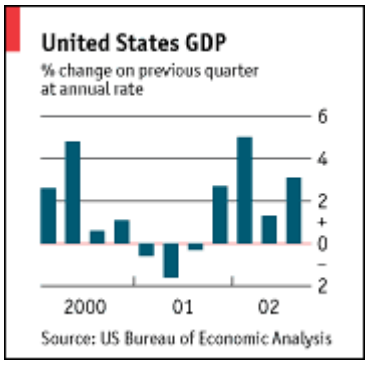
Business this week

Oct 31st 2002
From The Economist print edition

A loss of confidence



In the third quarter, **American GDP** grew by a relatively strong 3.1% at an annual rate. However, prospects are bleaker. Consumer spending, which has propped up America's economy for the past year, could be on the wane. The Conference Board's consumer-confidence index hit a nine-year low.

See article: Falling consumer confidence

Japan's bank-reform package materialised. As expected, a hard-hitting draft plan to deal with bad loans, involving big bankruptcies, nationalisation of banks and huge injections of capital, was diluted by senior politicians without the stomach for real reform.

See article: Too weak to work?

Grabbing for the phone

Vivendi Universal rejected Vodafone's offer for its 44% stake in Cegetel, a French mobile-phone operator, and won a further month to bid for a 41% stake owned by SBC and BT. French prosecutors began a probe into allegations of accounting irregularities at Vivendi in 2000-01 under Jean-Marie Messier, its former boss, after a complaint by a shareholder group.

See article: France's backward mobile-phone market

Qwest Communications said that it would write off assets to the tune of $35 billion to erase the last vestiges of the telecoms boom from its balance sheet. It also revealed that it had suffered a third-quarter loss of $214m, its tenth quarterly loss in a row.

Aegis, an American media-buying company, detected an improvement in the advertising market. The firm's shares rose after it said that broadcast-media advertising in America was on the up. WPP, a huge ad group with a pessimistic outlook, recently said that it saw no signs of improvement.

Cruise control

A long-running maritime engagement between **Carnival Cruises** and **Royal Caribbean** for **P&O Princess Cruises** ended with a victory for Carnival that will consolidate its position as the world's leading cruise company, in a deal worth $5.4 billion.

In an industry plagued by overcapacity, France's **Peugeot-Citroën** announced plans to build a factory in Central Europe. As car sales have faltered around the world, the French company has experienced booming demand for its products.

Japan's **Toyota** reported a 90% increase in profits in its first half-year. But at Germany's **Volkswagen** profits fell by 51% in its latest quarter.

BP announced that replacement-cost profits in the third quarter had fallen by 61% compared with a year

ago, to $761m. The British oil giant missed production-growth targets but promised a good year overall. Its shares sagged.

See article: BP's missed targets

Diageo's shares tumbled by 8% after it released three pieces of bad news: the withdrawal of a rum brand in America after poor sales; a decline in the fast-food sector that could affect the sale of its Burger King chain; and a notional shortfall in its pension fund.

The European Commission zapped **Nintendo**, a Japanese video-games firm, with a fine of *euro*149m ($143m) and demanded *euro*19m from its European distributors for keeping console prices artificially high in the EU during the 1990s. This puts the company at number five in the league table of cartel fines.

Deutsche Bank surprisingly reported a pre-tax loss in the third quarter of *euro*181m ($178m). The German bank has suffered from lower trading revenues and was forced to make a steep increase in provisions for bad loans. Its shares dipped.

Split decision

Citigroup responded to investigations of conflicts of interest at its investment-banking arm by saying that it would split the unit in two. Salomon will continue with investment banking while Smith Barney will return to its role as a stockbroker. The latter will include the research unit accused of skewing its findings to win banking business. Wall Street's big banks made an agreement with regulators to spend up to $100m over five years on providing independent equity research for retail investors.

See article: Wall Street research

America's **Securities and Exchange Commission** appointed William Webster, a former judge who once ran the CIA and the FBI, to head its new accountancy-oversight board, intended to restore the faith of investors in the probity of America's company accounts. A hard task will not be made easier by a public spat over his appointment at the deeply divided commission.

See article: Accounting regulation

A **worldwide accounting standard** came closer, after American and European regulators agreed to harmonise rules by 2005. America had insisted that any global agreement would have to follow its own accounting principles, but in the wake of Enron and myriad other accounting scandals it was forced to soften its attitude to European practices.

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Immigration

Opening the door

Oct 31st 2002
From The Economist print edition

Whom to let in to the richer countries and why

Get article background

A POSSIBLE conflict in Iraq; deteriorating economies in South America; famine in sub-Saharan Africa; turmoil in Indonesia; political instability in the Balkans. And in many developing countries, persistent crime, lousy education and a lack of opportunities for energetic people to prosper without graft and political connections. No wonder so many people want the chance of a better life in the stable, meritocratic economies of the rich world. No wonder they risk their life savings, or even their lives, to buy the hope of higher earnings, fairer treatment and better opportunities for their families.

This movement of humanity brings undoubted gains, and not just to the immigrants. The gap between earnings in the poor and rich worlds is vastly greater than the gap in the prices of traded goods. As our survey in this issue argues, the potential economic benefits to the world of liberalising migration dwarf those from removing trade barriers. Where populations are ageing and economies are sluggish, the benefits are especially great. Immigrants, unlike natives, move readily to areas where labour is in short supply, so easing bottlenecks. They bring a just-in-time supply of skills, too, which is why hospitals want to hire foreign doctors and nurses; farmers, spare hands to pick fruit and vegetables; and wealthy couples, nannies for their children. In many cases, immigrants also pay more in taxes than they cost in public spending.

But voters in rich countries often don't see things this way. Like other forces of globalisation, immigration is disruptive, and at the most intimate level. It changes the neighbourhood. People in the street speak odd languages; the neighbours' cooking smells strange. So immigration often meets passionate resistance. Even in countries built on immigration, like the United States, politicians hesitate to press for easier entry. America has refused to strike a deal with Mexico to let in more legal migrants. In Europe, hostility is deeper and can be more dangerous. In the past year, the far right has gained in elections in France, Denmark, Austria and the Netherlands.

The hostility may well increase. Immigration has boomed in the past decade partly because rich countries have created lots of jobs. If the economic slowdown persists, unemployment is sure to breed greater resentment. Another terrorist attack along the lines of September 11th 2001 would, rightly or wrongly, increase fears that immigrants threaten security. And, as HIV spreads in the poor world, rich countries will fret about the threat to their health services and the risk of AIDS.

How then to square the conflicting pressures of politics and economics? The first essential is to accept that the voters' right to a say about who and how many can enter must take precedence over the rights of those unlucky enough to be born in poorer parts of the world. The task of politicians—and of employers—is to persuade voters that immigration is not only inevitable but also in their long-term interests.

That will be possible only if migration is managed carefully. Voters resent illegal immigration, and not merely because illegals are particularly likely to undercut the pay of natives (and of other immigrants). Illegal migration, currently running at about 500,000 a year into both the United States and the European Union, indicates a breakdown of government control. However, tougher border controls are unlikely to help much. More important is a willingness to take stronger measures to force employers to

check workers' credentials.

With legal migration, governments need to persuade voters that they are accepting immigrants who will be good for the country, rather than simply those who manage to find a way through the entry rules. Some legal routes have become particularly prone to abuse. They include two that are especially sensitive in liberal democracies: asylum claims and family reunion. In particular, a United Nations convention (on refugees) more than half a century old is surely no longer a strong enough basis for deciding whether to admit tens of thousands of people each year.

Better ways

A workable policy would be more selective, not more restrictive. Countries could, for instance, freely admit the citizens of any country with broadly the same income per head as theirs, letting them work or stay as long as they liked. It makes no sense for America to limit the working opportunities of young Australians, or for EU countries to keep out Canadians.

In the case of migrants from the poor world, countries should give preference to those who seem to integrate most readily. That would often mean favouring not just the skilled (who already get preference everywhere) but those from culturally similar backgrounds. It might mean insisting that migrants learn the local language quickly; that they abide by local standards of tolerance and good behaviour; that they are wary of demanding special treatment in matters of dress or religious observance. Race and religion must be a part of the public discussion of migration. To pretend that they do not affect attitudes makes policy more restrictive than it should be.

What about the unskilled? No country's entry policy welcomes them. However, rich countries need them: to look after the old, to staff restaurant kitchens, to pluck chickens or gut fish. Better, surely, to create legal ways for some to enter—perhaps by an annual auction or lottery of places—than to leave them only the option of the back of a truck.

Making immigration policy less restrictive brings a further benefit. Draconian border controls discourage migrants from going home and facing a second dangerous and expensive trip when they next want to work abroad. Yet inexpensive travel means that the natural pattern of movement now is more one of circulation than of the one-way crossing of the emigrant ship. If immigration policy forces people to return, it will fail; if it facilitates and promotes return, all will gain.

If voters see that immigration is managed for their benefit and not for that of strangers, they may even learn to enjoy some of the changes it brings. It is the mix of colours and cultures that gives such exuberance to New York and London. Open the door, and let in new ideas, new foods, new businesses and a new buzz along with those eager new faces.

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The Securities and Exchange Commission

In trouble at the top

Oct 31st 2002
From The Economist print edition

Why Harvey Pitt should resign or be sacked

Get article background

AP

REGULATORS depend above all on their credibility. Compared with the industries they oversee, they tend to be understaffed, overworked and underpaid—and yet vitally needed. Right now this is especially true of America's Securities and Exchange Commission (SEC). The tales of corporate malfeasance that have emerged since Enron imploded, together with the Sarbanes-Oxley act that Congress passed in July, have put a heavy burden on the SEC to restore public confidence in the capital markets. It has become plain that, if it is to have the credibility required for the task, it needs a new head.

This is not because Harvey Pitt, the SEC's chairman since August 2001, is ill-qualified—he is a sharp securities lawyer who was once the youngest general counsel in the SEC's history. Nor is it because he is compromised by having worked in private practice for many accounting firms and investment banks; poachers do, in truth, often make the best gamekeepers. Nor, again, is it because he is overly partisan: he and two other commissioners are indeed Republicans, but they are balanced by two Democrats, and the commission usually works by consensus. No, the reason Mr Pitt must go is that he has repeatedly shown such ineptness as to lose the confidence not only of the politicians but, more seriously, of SEC staff and the financial markets as well.

Thus Mr Pitt fought vainly against almost all congressional plans to toughen audit regulation; so much so that the SEC was largely cut out of the bargaining over Sarbanes-Oxley, which emerged both worse-drafted and less coherent as a result. Similarly, Mr Pitt allowed state attorneys-general, notably New York's Eliot Spitzer, to take the lead in drawing up new rules on conflicts of interest in investment banks, something that should fall squarely within the SEC's purview. And most recently, Mr Pitt has been stunningly cackhanded over the appointment of William Webster as head of the new Public Company Accounting Oversight Board (see article).

Mr Pitt has repeatedly shown such ineptness as to lose the confidence of politicians, SEC staff and financial markets

Mr Webster, a distinguished former judge who has served as head of both the CIA and the FBI, is certainly a weighty figure, even if his experience of accounting is limited. The objection is not however to him, but to the manner of his appointment. Mr Pitt had earlier lit on a different candidate, a former pension-fund manager named John Biggs, who was known to have strong views on the need for tougher regulation of auditors. The accountants balked at Mr Biggs and lobbied both the White House and Congress. Mr Pitt duly backed down and opted for Mr Webster instead. Worse still, he not only denied being influenced by any lobbying but also rammed through his choice in public in a bitterly contested 3-2 vote, threatening the commission's consensual norm.

Despite this inauspicious background, Mr Webster could yet prove a success. He is no auditors' patsy, and his fellow board members seem a strong team. But by fracturing the SEC, quarrelling openly with two fellow commissioners and losing the support even of the mild-mannered Paul Sarbanes, the Democratic senator mainly responsible for the Sarbanes-Oxley act, Mr Pitt has shed most of his remaining credibility. In today's climate, with various prosecutors, regulators and legislators vying to promulgate new rules not just for Wall Street but for all of American corporate governance, that is disastrous. To ward off the risk of regulatory overkill, a strong and well-respected SEC chairman is needed now more than ever. Mr Pitt should fall on his sword to make way for one.

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Russia and Chechnya

Losers, both

Oct 31st 2002
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Do as you would be done by, damage as you would be damaged by

Reuters

PITY both Russia and Chechnya. Each loses from the likely aftermath of the brutal hostage-taking last week in Moscow. It is not just that the merciless war between Chechen separatists and Russian soldiers has now claimed more than a hundred new victims to add to the thousands already killed. With defenders like those terrorising Moscow theatre-goers, the notion of independence or even autonomy for Chechnya will garner only greater hostility in Russia and lose sympathy abroad. Far from withdrawing Russian forces, as the hostage-takers had demanded, President Vladimir Putin feels vindicated in painting all separatists as terrorists, and vows to intensify his crackdown inside Chechnya and outside. To Russia's cost, Mr Putin also refuses to see how his handling of the war in Chechnya sullies Russia's reputation too.

Russia's tit-for-tat tactics in Chechnya are an outrage in a country that aspires to be an accepted part of the civilised world

Defending against terrorism often requires harsh measures, but it also requires that democratic governments at least strive to hold the moral high ground. Mr Putin makes little such effort in Chechnya, and in Russia's coarse democracy few seem to care. The damaging evidence about the dirty war its troops have been waging in Chechnya is set out in successive reports adopted over the years by organisations to which Russia itself belongs, from the United Nations to the Council of Europe (see article). Or Mr Putin could take the word of the Chechen officials he has himself installed to help run the republic. In documented case after case, Russian troops stand accused of massive breaches of human rights and even of war crimes—disappearances, reprisals against villages, extrajudicial executions, torture, rape, extortion—yet few such cases are ever aired in Russia's courts, or even in its press.

Mr Putin is right that the guerrilla bands that roam Chechnya—and which he has accused of previous atrocities in Russia—are just as capable of the most awful crimes. But that serves only to emphasise that Russian tit-for-tat tactics in Chechnya are an outrage in a country that aspires to be an accepted part of the civilised world.

Fear and loathing

They are also a mistake. Military force will not crush the Chechens' desire to separate themselves from Russia. Mr Putin, fearing wrongly that if he lets this tiny but determined province go larger chunks would inevitably follow, justifies his refusal to negotiate with Chechnya's previously elected president, Aslan Maskhadov, by arguing that some separatists are little more than vicious al-Qaeda offshoots. Yet with no prospect of a political solution, Russia's brutal tactics merely drive more Chechens into the extremists' camps, Mr Maskhadov now possibly included. There have been opportunistic connections between the wilder Chechens and foreign funders, but this conflict is rooted deep in local grievances. And it is sustained, not by outside elements, but by local and Russian criminal interests, who profit from extortion

and the smuggling of all manner of goods, including drugs and guns.

Breaking this cycle of violence will be hard. But Mr Putin needs to start, if only because it is hard to see how new powers for Russia's troops and law-enforcement agencies will succeed in ending the war in Chechnya, where any supposed limits on their old powers in the past were anyway ignored. Cleaning up Russia's own act would help. Bringing those responsible for crimes against Chechen civilians to justice and ending the instinct for cover up that allows so many to get away, literally, with murder would counter the culture of fear and lawlessness that paralyses all progress. Elections due to be held next year can undermine the extremists, as Mr Putin hopes, only if Chechens can vote free from intimidation by both sides.

Outsiders can help a bit. Western governments should have no truck with Chechen opposition groups that refuse to condemn and expel the terrorists in their midst. But nor should they mince their criticisms of Russia's bloody tactics in Chechnya—something they have been inclined to do in public at least since Russia threw in its lot with the anti-terrorism coalition after the September 11th attacks on America.

But ultimately it is only the insiders—Russians and Chechens—who can end Chechnya's wars. The outline of a solution has already been thought of: an end to the fighting and a freeze on Chechnya's status for a period of years, but with locals given increasingly more powers, as the internal situation stabilises, to run their own affairs—and with separation at least not ruled out as one possible negotiated outcome. But that would take the sort of far-sighted leadership that has so far been lacking on both sides.

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Brazil's presidential election

Lula's hard choices

Oct 31st 2002
From The Economist print edition

Better pain now and gain later than the other way around

AP

THERE was no doubt about the result: Luiz Inacio Lula da Silva was elected as Brazil's president by a margin of 19m votes. Nor can there be any cavil about the significance for democracy in South America of the region's biggest country having chosen to elect the leader of its largest left-wing party. But none of that should be allowed to distort the nature of Lula's mandate. It is not for revolution. It is for moderate change, for consolidating an efficient capitalist economy in Brazil while trying to tackle unacceptable inequalities and injustices.

That much was clear from the campaign. Three times Lula had stood as an anti-capitalist radical and lost. This year, he made his rhetorical peace with economic reality and the IMF—and won over Brazil's mainly middle-of-the-road voters. Another moderating influence will be his need to share power. He will govern with a Congress in which his own Workers' Party (PT) won fewer than a fifth of the seats. And his party has won none of the governorships of key states—powerful jobs in a genuinely federal country.

None of this makes Lula's job any easier. But it should illuminate the choices facing him, as he grapples with the two, linked, challenges he faces: ensuring governability, and avoiding a catastrophic financial collapse. Though he does not take office until January 1st, his success in both tasks will be determined by what he does in the coming weeks.

On the first point, Lula repeated this week that he wants a broad “national pact”. He is right to recognise the need for allies. But not just any allies. Many of those who have rushed to embrace him represent the worst of Brazilian politics: unscrupulous populists, or conservative political bosses, who thinly disguise their appetite for pork with tired nationalist talk. Better by far would be an alliance between the PT and the parties that backed Fernando Henrique Cardoso, the reforming outgoing president, even if the wounds of the election campaign make that hard to pull off.

Given this need to construct a coalition, Mr da Silva cannot satisfy investors' impatience to know at once who will form his economic team. Anyway, it is more important for him to choose his finance minister and central-bank governor well than instantly: to find people with the required experience of financial markets and international financial institutions, he will have to look beyond the PT itself.

How to avoid a financial collapse

Uncertainty about who would follow Mr Cardoso, and mistrust of Lula, have helped to create a financial panic that has sliced 40% off the value of the currency this year, in turn driving up the cost of servicing the public debt to unsustainable levels. So Lula faces the trickiest of balancing acts. How can he fulfil his expensive promises (such as a doubling of the minimum wage) at the same time as he tames the public debt?

There is a way out. It involves appointing a reasonably market-friendly economic team, an even tighter fiscal squeeze and, if necessary, seeking further IMF aid. That should be enough to create a virtuous circle in which the currency strengthens, interest rates fall, growth picks up and the public debt

Mr da Silva should appoint a reasonably

becomes manageable. (Mr da Silva should press the outgoing Congress to approve pending measures to cut over-generous civil-service pensions and give the central bank greater independence.) Otherwise, Brazil may stumble back to inflationary chaos, or a debt restructuring which would wreck its banks and from which Lula's presidency might never recover.

market-friendly economic team, tighten fiscal policy further and, if necessary, seek more IMF aid

The noises on economic policy coming from Mr da Silva and those closest to him have been reassuring (see article). But the test will lie in implementation. The PT has no experience of national government, and roughly a third of the party remains wedded to the radicalism of the past. Social movements, such as unions and landless farmers, their expectations aroused, may quickly become frustrated. Lula will need to be adept in managing their disappointment.

Centre-left governments have often taken power amid similar doubts and problems. Those that have taken the populist route have quickly perished. Those that have prospered, such as Spain's in the 1980s and Chile's in the 1990s, have combined market economics with democratic reforms and gradual improvements in social provision. The road ahead will be bumpy, but its direction should be clear.

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World trade

Coming unstuck

Oct 31st 2002
From The Economist print edition

The Doha round of trade talks is in trouble

HOPES that the Doha round of talks to liberalise trade would mark a great advance, especially for the world's poorest countries, are fading. Governments continue to pledge their determination to make Doha work—to achieve genuinely multilateral reform of tariffs and trade-distorting rules and subsidies, under the auspices of the World Trade Organisation. Their actions belie this promise.

When trade ministers inaugurated the Doha talks a year ago, they said this would be a “development round”. They wanted it particularly to benefit poor countries, many of whose governments felt that they had done badly out of the previous Uruguay round. One of the main ways in which Europe and the United States can help is to dismantle their systems of farm support. This, or so the plan went, would elicit reciprocal lowering of tariffs and trade barriers on the part of developing countries. Farm-trade liberalisation seemed possible: the Bush administration had called for it and the European Union needed it anyway to ease the accession of new members. A grand global bargain seemed possible.

No longer. The United States has advocated farm-trade liberalisation, and it is recommending a radical scheme to its trading partners. But its seriousness in this effort has to be judged against the ugly reality of its egregious farm bill, passed in May, which promises some $180 billion of subsidy over the next ten years. America says this plan is consistent with its existing WTO commitments, though some doubt it. Policy would certainly have to be completely rethought if any new liberalisation was on the cards. And now, as if to seal the fate of farm reform, France and Germany have done a deal on Europe's common agricultural policy that underwrites its generously funded existence out to 2013 (see article). Again, this does not entirely rule out a farm-trade initiative in the Doha process—it would be possible to minimise the trade-distorting effects of the CAP without much reducing its costs to European taxpayers and consumers, if the EU is set on inflicting those costs. But the signs in both America and Europe are that the political will for reform is not there.

Meanwhile, alternatives—markedly inferior alternatives—to the WTO approach are gaining ground. This weekend sees a meeting in Ecuador to take forward negotiations on a Free Trade Area of the Americas (see article). These talks are unlikely to make much headway, as it happens: Brazil's new president is not keen, and the United States is hesitating because of the political sensitivity of, you guessed it, farm trade. Whether the FTAA would on balance be a good thing for world trade is debatable. There is no question, however, that a flurry of cross-cutting bilateral trade deals would be a far worse outcome than a proper multilateral agreement, or that a rush of such bilateral deals will make it much harder to make progress at the WTO. Unfortunately, a proliferating patchwork of bilateral deals is exactly what is now taking shape.

Members of the Association of South-East Asian Nations are working on a free-trade deal with China, and they are jointly and severally negotiating free-trade deals with other outsiders, including in Singapore's case the United States (see article). Indeed Robert Zoellick, the Bush administration's chief trade negotiator, has embarked on a worldwide quest to sign bilateral free-trade deals wherever he can—in South and Central America (FTAA notwithstanding), maybe with Australia and Morocco, and elsewhere in Asia, Southern Africa and the Middle East.

One way or another

Mr Zoellick continues to insist that this strategy is not an obstacle to progress in the Doha round, but rather a complement to it. Assuming he is sincere in this—as he might be, given that the launch of the Doha round owed so much to his efforts—he is nonetheless mistaken. This befuddlingly complex series of overlapping deals, each with its own pattern of preferences, schedules and exclusions, undoubtedly adds to the political and technical difficulties of negotiating a multilateral WTO deal. It makes it that much less likely that governments will even try. And, in the meantime, global trade takes place on a playing-field as level as the Himalayas, with the added spur to trade and investment of not knowing what the contours will be from one month to the next.

The Doha round is not beyond saving, but its prospects look grim. America and Europe need to stop and think.

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Letters

Oct 31st 2002
From The Economist print edition

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A constitution for Europe

SIR – It is hard to disagree with Jack Straw's views on the size and clarity of a European constitution but he misses a crucial issue (By invitation, October 12th). It is true that many organisations and clubs have a written constitution but they also rely on two other vital characteristics: a common purpose and trust that the organisation will deliver. Beyond the political elite that has so far driven European integration, evidence that citizens recognise either characteristic in the European construct, as it exists at the moment, is sadly lacking.

Andrew Bywater
Headless Cross, Worcestershire

SIR – Mr Straw likes to collect constitutions (UN, American, future EU) in his pockets, where quantity counts: "the smaller the better". Indeed, the infinitely small British constitution ranks highest by this standard. The nature of British constitutional arrangements are "settled" according to Mr Straw, who adds reassuringly that "at the heart of the way we run things are the timeless national institutions which are pretty well understood."

A foreigner would wonder what that means when, for example, he looks at parliamentary developments in Britain. We see a federal parliament at Westminster, and very young parliaments in Scotland and Wales, but no similar parliament in England. So, continental Europe, with your written constitutional cultures, give a welcome to British proposals for a European constitution but do not forget the very British constitutional culture behind it.

Willem van Hasselt
The Hague

SIR – Mr Straw is disingenuous when comparing the bulk of the consolidated treaties of the EU to the pocket size of the American and UN constitutions. Even if you accept that the consolidated treaties have a constitutional element (and many do not), they represent both the EU's constitution and its basic governing legislation. If you added America's basic governing legislation to its constitution, it would not fit into a pocket either.

Robert Satchwell
Haarby, Denmark

SIR – A realistic European constitution might read something like this. We, the peoples of Europe, hold these truths self evident:
1] That a complex and overarching supranational political body is fundamentally undemocratic, and always will be (see *Appendix A*).
2] That a core purpose shall be to pass money from the poor and middle classes of Europe to its inefficient farmers.
3] That a third purpose shall be to reward those who cheat the system and punish those who seek to render it reliable and uncorrupt.

Appendix A: voters will only be asked to vote when their vote can be relied upon to be the correct one.

Ian Dickinson
Gloucester

No to Turkey

SIR – Why should the European Union want Turkey ("Do you want us or do you not?", October 19th)? What benefit would sharing a border with the Middle East bring? The cultural heterogeneity of the EU is attested to by 30m Muslims already within its borders. Rather than adolescent mumbling about a common foreign and security policy, a "grown up" EU should be able to say "no thank you, but close relations" to Turkey. A truly democratic Turkey, were it to be so, would be able to accept "no" for answer.

Ulf Bergstrom
Stockholm

Near and present danger

SIR – The facts that you use to claim that people in Washington, DC, were exaggerating the perceived risk of being shot by the sniper ignore an important point ("The logic of irrational fear", October 19th). "Normal" murders and the sniper attacks are not directly comparable since they are not drawn from the same distribution. Most murders are not random—many victims and killers know each other—and most murders happen in poor and drug-stricken areas. So the random nature of the sniper attacks raised the risk for the majority of the population much more than what would be implied if the base murder rate were also random.

Dominic Mancini
Silver Spring, Maryland

Leading the way

SIR – Your survey of the world economy contains an error regarding forecasting (September 28th). In reference to the index of leading economic indicators (LEI) produced by the Conference Board you say that "unfortunately, the LEI failed to predict any of the past three recessions." The data flatly contradict this statement. The LEI turned down ahead of each of the ten American business-cycle peaks since 1948 and up ahead of the troughs. Its lead time in 2000-01 was long—about a year—and its decline, though mild, was persistent, thus deserving more attention than it got from many economists. While the index does not include or offer any predictions, it provides sufficiently early signals of most big turning points in the economy and serves as one of the most useful tools of macroeconomic forecasting.

Victor Zarnowitz
The Conference Board
New York

Siebel's customer research

SIR – In your article about Tom Siebel (Face value, October 19th) you imply that Satmetrix Systems skews customer-loyalty data for Siebel Systems because it has a minority stake in our company. I would like to set the record straight. Siebel Systems is a minority shareholder in Satmetrix Systems and the companies share a director. However, we take extreme measures to ensure the objectivity of survey responses for all of our clients as a founding principle of our company. We would be out of business if we did otherwise.

Andre Schwager
President and CEO
Satmetrix Systems
Mountain View, California

SIR – You say that Tom Siebel refers to Nucleus Research's analysis of a poor return on investment from sample Siebel Systems reference customers as "statistically insignificant" and intimate that the research "may even be propaganda financed by competitors." The suggestions of a conspiracy theory are, at best, ridiculous. Nucleus Research is an independent research firm and the study was commissioned by no one. We talked to customers that Siebel itself promoted so that we could provide our users with insight

into how to maximise returns from Siebel. Given that reference customers should ostensibly represent the best Siebel experience, perhaps Mr Siebel should be more concerned about their satisfaction than their insignificance.

Ian Campbell
Chief research officer
Nucleus Research
Wellesley, Massachusetts

Bridge building

SIR – You assert that the Tyne Bridge is a great piece of Victorian design ("Going up north", October 19th). In fact, it was built in 1929 during the depression to stimulate the economy and give employment, as well as to provide a new road crossing. Similarly, the new Gateshead Millennium Bridge is generating an economic renaissance on the Gateshead side of the river.

David Roberts
Newcastle-upon-Tyne

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Russia and Chechnya

The lost cause of the Caucasus

Oct 31st 2002 | MOSCOW
From The Economist print edition

Peace in the breakaway Russian republic of Chechnya has never looked easy, but the recent hostage crisis in Moscow has rendered it well-nigh impossible

Get article background

“NEGOTIATE?” retorts Zakir, a Muscovite of mixed Russian and Azeri descent, with an angry look. “Look here: you can negotiate with the Dagestanis, with the Circassians, with the Ossetians, but you can't negotiate with the Chechens!”

That is pretty much what the average Russian thinks about Chechens now; and it is pretty much what he thought about them long before last week's hostage crisis, in which Chechen militants held more than 700 people in a Moscow theatre for two-and-a-half days. The rescue operation, in which the gas that knocked out the attackers also killed at least 117 hostages, sparked local and international protest and left many questions unanswered (see article). But as the anger dies down and the questions start to be swept under the rug, trouble is only beginning for those who will be the attack's chief victims: the Chechen people themselves.

The police who idle away the hours on Moscow's streets checking identity papers and residence permits have always given more hassle to people with the dark hair and swarthy skin of the North Caucasus—people like Zakir. But now the scrutiny has intensified. This week police swooped to search the homes of even well-off Chechens and Dagestanis who have lived in Moscow for years. A call for tolerance from President Vladimir Putin made little difference. Old prejudice has hardened.

Since Chechnya tried to break away in 1991, Russia has fought two wars to try to bring it to heel. The results are a destroyed land, tens of thousands dead and hundreds of thousands made refugees; but above all, war has so permeated the fabric of Chechnya that it has become self-perpetuating. While optimists hope that the hostage crisis will shock Mr Putin into negotiating and the majority fear that it will only make him more implacable, the most awful thing is that it hardly matters. No solution—all-out assault, full military withdrawal or careful peace talks—will be easier than any other.

Born enemies

The Russians think the Chechens are bloodthirsty barbarians. The Chechens think the Russians are imperialist tyrants. History shows why. Slapped against the north face of the Caucasus mountains like a huge pancake, Chechnya is just one of the mini-nations that Russia began to swallow up in the 18th century as it expanded towards the borders of the Ottoman Empire. The people of the mountains resisted

invasion even more fiercely than their plains brethren: their greatest leader, Imam Shamil, waged guerrilla war for a quarter of a century. The Chechens always remained the least tamed of Russia's new subjects—perhaps because they had no traditional vertical hierarchy, but rather a network of communities and *teips*, land-based clans. Strong *teip* loyalty still exists, and is one reason why no truly all-Chechen leader has emerged—in itself, one of the biggest obstacles to peace.

Joseph Stalin made the Chechen-Ingush region an autonomous republic within Russia in 1936. But at the height of the second world war he deported the entire population, half a million people, to Central Asia, ostensibly as a punishment for "mass collaboration" with the Nazis. Most probably, as Carlotta Gall and Thomas de Waal argue in "Chechnya: A small victorious war" (Pan Books, 1997), it was because they had resisted Stalinist collectivisation, and would be the natural leaders of the mountain peoples in any future insurgency. Within five years, a quarter of them had died. Not until 1957 was the republic reinstated.

It declared independence from Russia in 1991, after the Soviet Union broke up. Russia, itself a new state, tolerated the rebellion at first. But under the Chechen president, Jokhar Dudaev, the economy collapsed and organised crime became rife. In 1994, Moscow supported an opposition coup against Dudaev; when that failed, Russian forces invaded.

They left 18 months later, humiliatingly defeated. The Chechen chief of staff, Aslan Maskhadov, had united rag-tag bands of rebel troops into a victorious army, like Shamil before him. And yet he was the most moderate and pragmatic Chechen leader around: he signed the eventual peace agreement with Moscow, and those Chechens who had not fled during the war elected him president in 1997.

But trying to rebuild a shattered republic—only one building in Grozny, the capital, was deemed safe enough to hold his inauguration—and unite competing interest groups proved too much for him. Chechnya became a bandit state, with the rebel commanders and *teip* leaders fighting for control of lucrative shady businesses.

Moreover, the peace deal left one question open: Chechnya's independence. Talks about it were repeatedly called off, often on the pretext of fresh terrorist attacks. Charles Blandy of the Conflict Studies Research Centre, part of the British defence ministry, argues that Moscow may have deliberately prevaricated. "Whilst Maskhadov was a person with whom the Russian authorities could work," Mr Blandy writes, "they perhaps recognised, too, that he was possibly the greatest threat to Russian ambitions of keeping Chechnya within the Russian Federation."

If that was the tactic, it worked. Disillusioned with a fruitless peace, Mr Maskhadov's field commanders joined the opposition. One of them, Shamil Basaev, together with a Saudi Arabian mercenary known as Khattab, led a rebel force into neighbouring Dagestan in August 1999. A month later there was a series of bombings in Moscow and elsewhere—blamed on Chechens, though there was never any proof. Those events gave Russia the support it needed for a second invasion.

The campaign was masterminded by the new prime minister, Mr Putin. Its initial success helped him win the March 2000 presidential election. But once again, the mountain region proved much harder to capture than the plains, and soon the army got bogged down. Although Mr Putin declared the military operation over earlier this year, rebels still control much of the southern part, and kill 20 to 30 Russian soldiers each week. Often, they also attack the pro-Moscow Chechen officials who are nominally in charge of most of Chechnya.

The wages of sin and death

Since the hostage affair, Mr Putin has vowed to strike against terrorists "no matter where they are" and hints at expanding the army's powers. But it is unclear what he will do about Chechnya itself.

Many observers think that he will favour some sort of renewed military campaign. But it is hard to see what else the Russian

Magnum

army could do, since after three years and with 80,000 troops it has still not brought Chechnya under its thumb. More likely, perhaps, is a renewed effort to track down warlords like Mr Basaev; but the internal security service, the FSB, has been hunting him for years without success. And the Moscow attack showed that there are always more militants in waiting: Movsar Baraev, the 25-year-old chief hostage-taker, was the nephew of a notorious Chechen warlord reportedly killed by the Russians last year.

A nice little earner

Moreover, though support for a military campaign has jumped since the hostage-taking, that may not last. Until then it had been falling steadily, from about two-thirds of Russians when the war started to one-third this summer. Desertions and draft-dodging are already chronic problems for the Russian army, and a new war would make them worse.

Its consequences for Chechnya would be more severe still. Besides the thousands of deaths, 300,000-400,000 people have fled their homes since the wars began, out of a population of a little over a million. Rebel forces kill and torture both Russian officials and Chechens suspected of collaborating with them. As for the Russian troops, according to a recent report by Amnesty International, their treatment of prisoners includes rape of men, women and children, electric shocks and cutting off ears and fingers. And since the end of large-scale military manoeuvres the Russian campaign has turned into a series of so-called *zachistki* or “clean-ups”—searches for rebel troops that turn into orgies of murder and looting.

Which is why a second option—Russia's total withdrawal from Chechnya, as the hostage-takers in Moscow demanded—is equally implausible. Russian troops make a good deal of money out of the war, and not just by stealing. There is a steady trickle of press reports about soldiers caught selling weapons to the rebels. The trade is impossible to quantify, but Mr Basaev, now the most powerful Chechen warlord, once boasted that he got 90% of his arms from Russian troops. Two years ago a Moscow daily quoted an FSB general as saying that most of the Chechens' weapons were Russian-made. There are other forms of corruption, too: last year the government's accounting board found nearly $45m, most of it soldiers' salaries, missing from the war budget.

Another nice little earner is the illegal oil trade. According to a report in September by the Institute for War and Peace Reporting, a London-based non-profit organisation, over half a million tons each year of oil extracted in Chechnya are illegally turned into low-grade petrol at thousands of home-made micro-refineries. The trade began after the end of the first Chechen war, when the rebel commanders divided up the region's oil wells among themselves; but now soldiers and police often extort a cut from the refiners in return for turning a blind eye, or even helping transport and sell the petrol. Waste from the refineries poisons rivers and gives even small towns air pollution worthy of an industrial city.

An alternative to home-brewing petrol is to become a rebel fighter. There are bounties to be had for killing Russian troops and blowing up their vehicles. Some of the money comes from Islamic extremist groups that began to flourish in Chechnya during the first war. Press reports have suggested that up to $30m for the invasion of Dagestan in 1999 came from Osama bin Laden, and some money from Islamic charity organisations that collect for Chechnya may have wound up in rebel hands. The rebels also keep a tight rein on other illegal sources of income, such as drug-trafficking and kidnappings.

The war is profitable for all concerned

In short, the war is profitable for all concerned. And for the Chechens who want to stay in their ruined country, there is no other way to make a living. Jabrail Gakaev, a Chechen historian at the Russian Academy of Sciences, calls the profit motive “the major driving force of the continuing violence”. Withdrawing the army suddenly would hurt a great many vested interests. Moreover, Chechnya is too ruined and anarchic simply to be left to fester on Russia's doorstep.

No voice in the wilderness

So how about peace? This week the World Chechen Congress, meeting in Copenhagen, asked Ruslan Khasbulatov, an ethnic Chechen and former speaker of the Duma, to try to mediate between Moscow and the rebels. Mr Maskhadov has also sent the message that he is ready to sit down to unconditional talks.

But the closest the two sides have ever come to negotiating was last year, when an envoy from Mr Putin met an envoy from Mr Maskhadov at a Moscow airport and told him that there could be talks—but only if the rebels first laid down their arms. Since this was like asking Yasser Arafat to shave his beard and don a pink skirt to negotiate the final status of Jerusalem, there was no further progress.

Constantly sidelined by Moscow since he was elected, and rapidly losing his remaining grip on power, Mr Maskhadov over the summer did what many think was inevitable: he reunited the rebel factions and gave government posts to radical commanders who had previously broken with him. That step may have put him on firmer ground at home, but it lost him all stock with the Russian government—and the American one, which publicly distanced itself from him. The hostage-takers claimed that Mr Maskhadov took part in the planning, or at least knew of it. If that is true, says one government source, then he could be “in line for special-operations removal”. (His envoy, Akhmed Zakaev, was arrested this week in Copenhagen at Moscow's request.) Even if it is not true, nobody in Moscow now trusts him.

Yet no other credible leader exists. Mr Basaev, probably the next-most-powerful man in Chechnya, was named by the hostage-takers as their “supreme military emir”. The smaller-fry commanders are just as bloodthirsty. There are shrewd, moderate and well-connected Chechen businessmen and politicians in Moscow, but they are there because they fled the conflict. None can really speak for the people, nor seems keen to take on the risks of running the place. Akhmad Kadyrov, the head of the unpopular, Moscow-imposed Chechen administration, is a likely candidate for the next presidential election, due in January; but even if he wins as the least-bad of the bunch, he will find it at least as hard to rule as Mr Maskhadov did.

And the election may not even take place, since legally the Chechens first need to hold a referendum adopting a new constitution. The first article of that constitution will be about the status of Chechnya. In current drafts, it says that Chechnya remains part of the Russian Federation. What the Chechens in Chechnya (never mind those in the diaspora) want right now is anybody's guess. It may be that after so many years of war, the majority would trade independence for peace—at least until the country is somewhat restored. The tragedy is that nobody with the power to give them peace wants to; and nobody who wants to has the power.

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The hostage 'rescue'

Death in the theatre

Oct 31st 2002 | MOSCOW
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Vladimir Putin's government pushes the questions away

Get article background

Reuters

Unnecessarily killed

LAST week's 60-hour stand-off in a Moscow theatre, where 50 Chechen rebels held over 700 members of the cast and audience, ended with what seemed a successful rescue. But as time has passed, more people have died: 119 at the last count (or maybe 118, or 120—official sources cannot agree), all but one (or two, or three) from the effects of the gas that Russian special forces used to put the terrorists to sleep. And with more reports comes more confusion.

At first, the assault was a response to the terrorists beginning to execute hostages. Then one survivor said that the first shots were not an execution, but a warning to a hostage who had suddenly started running around. One rescuer told the press that, despite the gas, some of the terrorists stayed awake long enough to shoot at them—and yet not a single one detonated the explosives that they had set up around the theatre and on their own bodies, like the suicide bombers they claimed to be.

Even so, it would not have been a high death toll, as hostage crises go. But then came the strangest and cruellest twist of all: the government not only refused to name the gas it used, but would not tell doctors how to treat the victims. The official reason was to keep the information from future terrorists. Only four days later did the health minister, Yuri Shevchenko, say that the gas was an unspecified derivative of fentanyl. Some forms of fentanyl are heroin substitutes, but up to a thousand times more powerful. One form, Alfentanyl, which is used as a hospital anesthetic, was tested by American researchers in the 1990s as a law-enforcement tool but rejected because it could be lethal in larger doses. Mr Shevchenko insisted that the gas only killed people who were ill, tired, hungry or stressed. After two days in that theatre, who wasn't?

Despite it all, 85% of Russians polled this week supported President Vladimir Putin's action. All the same, the government has concentrated on information damage-control. The first hostages released told the media that the rescue was the right thing to do. The state-owned channels began sprinkling their programming heavily with heroic hijack films and war documentaries. And Danish police, fulfilling Mr Putin's promise to strike at terrorists wherever they are, arrested a Chechen envoy in Copenhagen for possible extradition. All this conveniently deflects attention from the debacle in Moscow.

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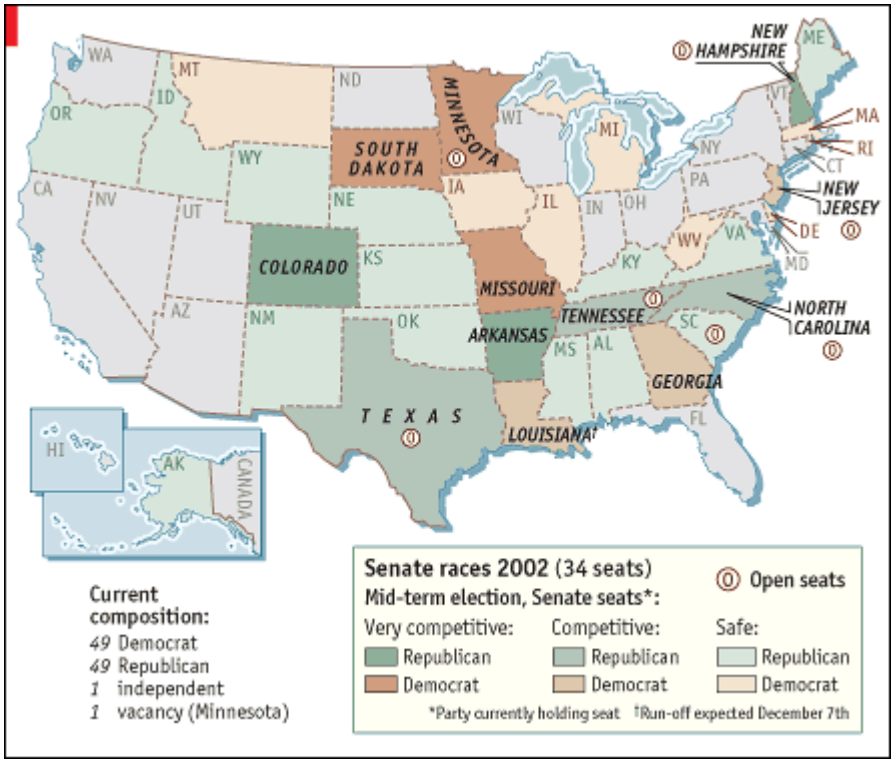
The mid-term elections

Curb your enthusiasm

Oct 31st 2002 | WASHINGTON DC
From The Economist print edition

In the last week of a becalmed campaign, a puff of wind behind the Democrats



IT IS often called the “Seinfeld” election—a patternless, meandering campaign about nothing. A better term might be the “Curb Your Enthusiasm” election, after another television comedy also about nothing, but with a blacker tone and a title more in keeping with a poll in which only one in three voters will show up.

That is how it has been for weeks. America's mid-term elections have not been a national campaign with any over-arching theme. Rather, this has been a series of local races about local personalities. Only 16 seats in the House of Representatives are really competitive, thanks to a process of gerrymandering (sorry, redistricting) which has made most seats safe for incumbents. The Senate is perfectly balanced, with each side defending three toss-up states (see map).

This has made Republicans cock-a-hoop. The party that holds the White House has lost seats in 32 of the past 34 mid-term elections. The biggest losses occurred in 1982 and 1994 when (as now) the economy and stockmarket were weak. Ken Mehlman, the White House political director, has argued Republicans could defy history this year by retaining control of the House and even retaking the Senate.

Even if that forecast turns out to be optimistic, the fact remains that the biggest single feature of the election so far has been Democratic weakness. Unable to decide whether to call for repeal of tax cuts, running the gamut on Iraq from strong support for war to virtual appeasement, divided on the issue of tighter gun laws (pushed into the spotlight by the Washington sniper), the Democrats' performance has been dismal.

Yet in the past week, a nationwide shift has begun that could impose a pattern of sorts on this formless

campaign: it is becoming more like the traditional referendum on the economic performance of a president. And that changes the dynamic of the race in the Democrats' favour.

In the most recent Gallup poll of voting intentions in House races, 49% of likely voters said they would back Democrats, against 46% for Republicans. Among registered voters, the Democratic advantage was greater, 50% to 41%. Polls by CNN/*Time* and Ipsos/Reid also put Democrats ahead by four to six points.

This marks a change. Since August, just before debate began on Iraq, the Democrats had seen their polling lead fall each month; Republicans had been ahead on some recent measures. That trend has now been reversed. But it does not look like enough to alter the balance of power on Capitol Hill.

According to Charlie Cook, one of the capital's most trusted political analysts, Democrats can be confident of 202 seats in the House of Representatives. Since they need 218 for a majority, they would have to win all of the 16 toss-up races. This is theoretically possible if a last-minute shift tilts all the marginal seats their way. But it is highly unlikely because only two of these races are in the five biggest states. The rest are in small or empty states, most of which President Bush carried in 2000.

The campaign is becoming more like a traditional referendum on the president's economic performance. That works in the Democrats' favour

The Democrats' chances of holding the Senate look better (see table). Tom Mann of the Brookings Institution argues that they could pick up two of the three most vulnerable Republican seats (New Hampshire, Colorado and Arkansas). If their position continues to improve, they might even pick up one of the next tier of Republican vulnerabilities (Texas, North Carolina and just possibly Tennessee).

On the other hand, Democrats are still likely to lose one or two of their most marginal seats. Missouri and South Dakota are most vulnerable, while Minnesota is a special case: after Paul Wellstone's death (see article), no one knows what will happen, though the chances are that sympathy for the senator may drive up Democratic turnout. Democrats are also likely to pick up anywhere between three and seven governorships.

The battleground
Voting intentions, selected Senate races, %*

	Republican	Democrat
Arkansas	43	48
Colorado	42	39
Georgia	41	47
Louisiana†	17‡	44
Minnesota	39	47
Missouri	47	46
New Hampshire	48	46
New Jersey	40	49
North Carolina	45	41
South Dakota	48	45
Tennessee	47	37
Texas	45	41

*Averages from most recent polls, as of Oct 30th
†50% of vote needed to win, run-off expected Dec 7th
‡Leading candidate in three-way split
Sources: *National Journal*; press reports

The net result of these bottom-up calculations is that both parties could keep their existing tiny majorities in Congress—producing more gridlock. But because the power is so finely balanced, any result is still possible. The best way to think about the Democrats' modest gains in the past week or so is that they have twisted the kaleidoscope slightly—not enough to create a new Democratic majority, but enough to create a pattern out of what had looked random. That pattern is the same as in the 2000 election—a 50:50 nation.

Until this week, conventional wisdom had held that the economy would not trump war in voters' minds; that even if national security did not dominate it would nevertheless prevent the election from being about any one thing; and that neither party would gain a decisive advantage from “their” issues. National security would not help Republicans (because some Democrats had supported the Iraq resolution); and economic issues would not help Democrats (because voters would not blame President Bush). These conclusions now look dubious.

It's the economy again

The Pew Research Centre found that the economy is much more important than either the war on terror or Iraq: 55% want to hear candidates' views about the economy, only 7% their views about Iraq. Most other polls confirm that the economy has risen to the top of voters' concerns.

Republicans respond that there is still nothing like the anger among the electorate that existed in, say, 1994. The economy is in better shape than the Democrats say it is. Even after Enron, corporate abuses have had little impact. And the Democrats have no convincing alternative.

Much of that is true. But two things are changing. Voters seem increasingly to trust Democrats on the economy more than Republicans. And economic anxiety is rising. This week, the Conference Board reported that consumer confidence plunged 14 points in October, and now stands at its lowest since 1993. Voters may not be angry, says Karlyn Bowman of the American Enterprise Institute, but they may be getting anxious enough to vote for change—regardless of whom they blame for the economy and regardless of whether they prefer the other side's policies.

For much of the past few weeks, these trends have been masked by the president's personal popularity amid talk of war on Iraq. It is still possible that a United Nations resolution could give his party a fillip at the last minute. But at the moment, renewed emphasis on the economy and the diplomatic dance at the UN have been pushing his job approval down.

In January, over 80% of Americans approved of the way Mr Bush was doing his job. That number is now in the low 60s—not bad compared with Bill Clinton in 1994 (44%), but still a big fall. Worse, the drop has been accompanied by a decline in his reputation for good economic management (only 49% approval on that front) and a decline in support for a possible invasion of Iraq. Mr Bush's performance as commander-in-chief in the war on terrorists clearly rallied support behind his party. A possible war against Iraq is not having the same impact.

Mr Bush, of course, is not on the ticket, but he has some cause to worry about these numbers. He has campaigned vigorously for his party and, where he can, has marshalled the power of the federal government behind his party's efforts. Yet little more than a year after the terrorist attacks of September 11th, 2001, and with Iraq and national security still in people's minds, he has failed to make any impact on the even division of America.

That may not be surprising. The two parties have gone out of their way to fudge their differences. The election has mostly been about winning over whatever tiny demographic sliver of the electorate is fashionable this week. And big shifts in a divided nation are hard to achieve at the best of times. But Mr Bush does not seem to have attracted many Democrats to his party's ranks. In so far as these mid-term elections have presidential implications, they point to continued stasis in 2004.

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And you thought politics was simple

Musical gavels

Oct 31st 2002 | WASHINGTON, DC
From The Economist print edition

Control of the Senate may change again after the election. And again. And again

THIS year's election is to decide which party will control the new Congress. But the next two months may be dominated by who controls the current one. The 107th Congress, though currently adjourned, meets again in mid-November to deal with budget and homeland-security matters. Control of this lame-duck session could change three times.

The Democrats have held a one-seat majority in the upper chamber ever since Jim Jeffords defected from the Republicans in May 2001 to become an independent. If the Republicans can get 50 seats they can retake control, because the deciding vote lies with the vice-president, Dick Cheney.

The weirdness starts on November 5th (see table). Two swing states, Missouri and Minnesota, have both lost their elected Democratic senators in aircraft crashes. Mel Carnahan was killed shortly before the 2000 election; still, Missouri's voters elected him, knowing that his wife, Jean, would be appointed to take his place until 2002. There is now a special election to fill the remainder of the term. If the Republican candidate, Jim Talent, wins, he can take his seat immediately. The same, more or less, applies to Minnesota, where Paul Wellstone was killed last week; Governor Jesse Ventura looks likely to appoint whoever wins on November 5th to the seat immediately, although he is now in a strop with the Democrats.

A decent guess would be that the Republicans will win Missouri, but lose in Minnesota—thus regaining the Senate, but only by one seat. They could then use their control of the legislative machinery to confirm plenty of judges and even pass a few new laws.

Changing places
Possible control of Senate, Nov 2002-Jan 2003*

	Dem	Rep	Indep/ vacant	Control of chamber
To Nov 5th	49	49	2	Dem
Nov 5th-Dec 2nd	49	50	1	Rep
Dec 2nd-7th	49	49	2	Dem
Dec 7th-Jan 3rd	49	50	1	Rep

*Assumptions: Republicans win either Missouri or Minnesota; Frank Murkowski wins Alaska governorship
Source: *The Economist*

But only until December 2nd. That is the date when Senator Frank Murkowski, an Alaska Republican who still has two years left in his term, is likely to be sworn in as governor of Alaska (he is running, and should win). The putative Governor Murkowski can appoint another Republican to finish his term, but Alaskan law requires him to wait five days after being sworn in to do so. So the Republicans would lose control until December 7th; and then get it back until the end of the 107th Congress, which could be as late as January 3rd.

And the 108th Congress? That hardly looks simple. In Louisiana, if none of the contenders for the Senate receives 50% of the vote (as is likely), there will be a run-off on December 7th. Meanwhile, if Representative Patsy Mink of Hawaii, who died last month, is re-elected posthumously (again likely), there will be a special election on January 4th.

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Getting people to vote

Come on, do what you say

Oct 31st 2002 | WASHINGTON, DC
From The Economist print edition

The parties fight to shove their supporters to the polling stations

IN THE end, it's turnout that counts. The Democrats and the Republicans are both spending the last few days before the November 5th elections trying to make sure their supporters go to the polls. The last-minute blitz may not push turnout up to 40%: this is, after all, not a presidential-vote year. But it could make all the difference in a dozen close races across the country: enough to decide who controls the Senate in Washington and some important governorships, such as Florida's.

AP

Even an armed Moses is no match for a big trade union

The Republicans go into the turnout war with two big advantages. One is money. In the current election cycle the Republicans have spent $303m compared with the Democrats' $170m. The second is relative enthusiasm. A Gallup/CNN/*USA Today* poll says that 65% of Republicans are either “extremely” or “very” willing to vote, compared with 55% of Democrats. This is not particularly surprising: Republicans are, on the whole, richer, better-educated and more “solid” than Democrats.

Yet neither advantage is a clincher. Four years ago, the Republicans had an even bigger lead among likely voters, and still ended up losing seats. The Democrats are making up for their (relative) lack of money by aiming it mostly at tight Senate races. And people on both sides of the political divide admit there is more to politics than money. The biggest item on the budget of most campaigns is television advertising. But the impact of this is being diluted by the multiplication of television channels, growing hostility to negative advertising—and the remote-control zapper. The AFL-CIO trade-union group has given up buying television advertising.

For some years, the Democrats have been better at taking voters by the elbow to the voting station: enough to add a couple of points to their polling numbers, according to Larry Sabato, of the University of Virginia. They have a large number of well-manned and highly-motivated organisations to aid them: the AFL-CIO, the teachers' unions, black churches and various liberal pressure groups—environmentalist, feminist, gay and the rest of it.

Both the Democratic National Committee (DNC) and the AFL-CIO have dramatically improved their get-out-the-vote operation in the past few years. Union households, which account for about 19% of the country's population, increased their share of votes cast from 23% in 1996 to 26% in 2000. With today's technology, Democratic vote-ralliers now wander from door to door collecting relevant material on Palm Pilots and downloading it into centralised databases. The DNC has also set up a voting-rights institute that stands ready to litigate at the drop of a hat.

The Republicans have little of this human infrastructure. The 4m-strong National Rifle Association remains the best source of Republican manpower. Charlton Heston has been stomping through states challenging the forces of illiberalism to pry his guns from his “cold dead hands”. But Mr Sabato says the NRA does not pack the punch of a single big union.

The Christian Coalition, which played a vital role in the Republican victories of the 1990s, is a shadow of its former self. The organisation lost much of its lustre with Ralph Reed's retirement in 1997, and some of its financial clout with the loss of its tax-exempt status in 1999. But its decline also reflects deeper forces. Many Christians are disillusioned with the world of Caesar. This year's meeting of the Christian Coalition was a sparsely attended affair, which came to life only to roar its support for Israel's Ariel Sharon.

In the past the Republicans have tried to make up for their shortage of foot soldiers by buying help off the shelf: so many consultants, so many paid advertisements, so many telemarketers and envelope-stuffers. This approach comes naturally to many Republicans, happier signing cheques than marching arm-in-arm with their comrades. It also has powerful defenders among the thousands of consultants who make a handsome living from it. But the 2000 election persuaded the party that it must do better. The Republicans had a rough five-point advantage in the week before that election. The Democrats obliterated that in the last three days. In virtually every state with reliable data, Mr Bush did worse in the actual election than he had done in the last opinion poll before it.

The Republican National Committee set up a taskforce to learn from the Democrats' success in those vital three days, and has spent the past two years test-marketing and fine-tuning its ideas in races around the country. It found a 2-4% increase in turnout when precinct workers “flushed” Republicans to the polls just before election day, and a 5% increase in turnout when volunteers, rather than hired callers, manned the telephones.

The business world is also trying to improve its performance. Companies have two obvious advantages when it comes to talking to their employees: open lines of communication (often through company intranets) and a reservoir of trust. They can also use the fact that many employees are also shareholders to push the boundaries of what they can say to their employees without raising any legal problems. But companies are still neophytes in this business compared with the trade unions.

All this may bring some old-fashioned enthusiasm back into politics. But both parties have a secret weapon to stop people getting too enthusiastic: lawyers. The Democratic National Committee claims that the party will have some 10,000 lawyers posted in “sensitive areas” to make sure that voters are not turned away at the polls. The Republicans are busy discovering dirty tricks by Democrats to register dead people to vote. The attorney-general of South Dakota is already investigating charges of voter fraud on Indian reservations, usually Democratic strongholds.

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Iraq and the United Nations

Slouching towards a resolution

Oct 31st 2002 | WASHINGTON, DC
From The Economist print edition

A wobbly compromise, maybe?

Get article background

SMOKE signals from the United Nations were at mid-week suggesting that the United States and France might just possibly be feeling their way towards a compromise on Iraq. The Americans would agree to consult the Security Council before embarking on military action against Saddam Hussein. But in the last resort they would reserve the right to act alone.

France and America have been arguing for the past six weeks about exactly what mechanisms might produce a UN-backed military strike against Iraq. The main sticking-point has been the clause in the American resolution which says that any failure by Iraq to comply with the UN resolution "shall constitute a further material breach" of its obligations—a phrase previously invoked by Washington to justify military action. The French say this would constitute a "hidden trigger" because it presumes to know what the Security Council will decide without giving it yet another chance to examine Iraq's behaviour.

The possible compromise would allow both sides to save face. America would agree to take part in a Security Council debate if Iraq fails to comply with UN demands for the elimination of its weapons of mass destruction. This means that the Americans would not be able to use a minor problem with the inspection regime as an excuse for invasion. But they would reserve the right to lead a military strike against Iraq, without having to go through the UN mincing machine again, if Iraq continues seriously to block inspections.

Smoke signals may prove nothing. But the Bush administration has made it clear that it expects the Security Council to vote on a resolution in the next few days. And both sides have an interest in producing a compromise. The French do not want to see the UN (and with it the last vestiges of their own fading power) sidelined by the United States. And George Bush wants to build a broad coalition against Iraq.

The last point is worth emphasising. Over the summer the administration was sharply divided between the hawks in the Pentagon and the vice-president's office, who wanted America to build an ad hoc coalition, and the doves in the State Department who wanted to go through the United Nations. The doves eventually won that argument. But the hawks have made it clear that they would seize on any disaster in the UN as a reason for again wheeling out their coalition plan.

Michael O'Hanlon of the Brookings Institution argues that Mr Bush is proving much more of a multilateralist than many people expected. Mr Bush's heart may have tempted him to side with Donald Rumsfeld, his defence secretary, and Dick Cheney, his vice-president. But in the end he listened to Colin Powell, his secretary of state, and his father, a veteran multilateralist. Mr Bush has had no shortage of opportunities to pull the plug on the UN. Multilateralism, he seems to have decided, will make it easier to sell a war to both the American people and Arab states.

The hawks are not convinced. They fear Mr Bush may fall into an "inspections trap", in which Saddam Hussein will go on buying time by owning up to a mere fraction of his stockpile of weapons, frustrating, yet again, the UN's inspectors and hiding his weapons of mass destruction until the arrival of hotter weather makes military action much harder. James Woolsey, a former head of the CIA, wonders how 80 inspectors in a country the size of France, with a terrorised population, will have any hope of getting at the truth.

The curious thing about the administration's mood at the moment, given the UN's ponderousness and the

hawks' scepticism, is how little anger there is. The explanation? Both the hawks and the doves suspect that Saddam Hussein will fairly soon do something foolish enough to provide his would-be disarmers with a cast-iron excuse to enforce their will.

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Voting

Early birds catch worms

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Is American democracy improved by early voting? Not necessarily

AMERICA'S election day, November 5th, might more accurately be called its election deadline. To coax more Americans into performing their civic duties, many states now allow voters to cast ballots, either by mail or in person, about a month before polling day. In 2000, 14% of all votes were cast early, and in states such as Arizona, Colorado and Tennessee the figure was closer to 30%. This year, the numbers should be even higher.

A few states have been voting early for more than a decade: Texas started in 1987. But until the early 1990s most states let people vote by post only if they had a good excuse, such as disability or illness. The big nudge forward was a set of 1993 laws that required states to ease the registration process. Now people can demand postal ballots for simpler reasons, such as business travel or going to college. More than 20 states require no reason at all. Since 1998, Oregon has had an entirely mail-in election system. Other states offer booths—usually in government buildings but sometimes in shopping malls—where people can vote in person before election day.

Both parties are mounting strong drives to get their people to vote early. Since most non-voters are thought to lean Democratic, the Republicans have resisted looser voting rules. But Thomas Patterson of Harvard University reckons that early voting is a toss-up between the parties: for every new working-class Democratic voter who casts a convenient early vote, a wealthier Republican votes as well.

All this presumes that early voting is a good thing. It certainly allows more time to consider the decisions, which is often necessary. In New Mexico, the ballot this year is an 83-item monster that may create queues on election day. Florida, ominously, also has a long ballot, filled with amendments about where to keep pregnant pigs and indoor smoking, which may be more easily studied at the kitchen table.

Since people often say they don't vote because they are too busy, you might expect early voting to raise the turnout—especially this year, since officials in western states claim a huge number of ballots are being properly returned. But Curtis Gans, a voting expert based in Washington, DC, points out that, historically, the picture is more muddled. States that allow early voting and absentee ballots have not performed well: in years of high turnout they show the smallest increases, while in bad years they show the biggest decreases.

Nor does early voting broaden the electorate. Such voters tend to be party loyalists, not independents. Early voting may even encourage apathy. In order to catch the early birds, candidates now start their advertising sooner, much of it nasty. That gets out the faithful, but scares off normal types. And early voters can also miss big news at the end of a campaign. In Minnesota absentee votes already placed for Paul Wellstone will not count for his Democratic replacement, Walter Mondale.

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The deep South

True-grits Republicans

Oct 31st 2002 | ATLANTA, COLUMBIA, LITTLE ROCK AND RALEIGH
From The Economist print edition

The Democrats are still some way from reclaiming their ancestral heartland

BACK in 1954, when Strom Thurmond was first elected as a write-in senator for South Carolina, the South was a Democratic fief. Now he is retiring—having, in the meantime, become a Republican senator. The deep South has changed sides. Have the Democrats any hope of luring back southern white conservatives?

George Bush has criss-crossed the South in the past couple of weeks, and the odds are that his fortress is not yet at the point of collapse. To be sure, the Republicans have problems in Arkansas. Senator Tim Hutchinson, who won his seat in 1996 as a clean-cut Christian and then ran off with a member of his staff, may lose to the Democrats' Mark Pryor. And the race between Mike Huckabee, the Republican governor, and Jimmie Lou Fisher has narrowed dramatically, with Bill Clinton campaigning hard for Ms Fisher. But elsewhere in the deep South the Republicans look likely to retain their Senate seats and perhaps pick up a few governorships.

In the race for Mr Thurmond's seat in South Carolina, a rather mechanical conservative Republican, Lindsey Graham, looks set to hold off the challenge of an entertaining liberal maverick, Alex Sanders. One poll this week put the circus-performer-turned-college-president within three points of Mr Graham; but he would need a record turnout of blacks to win. In Tennessee Lamar Alexander, a plaid-shirted one-time presidential candidate, seems likely to hold Fred Thompson's seat for the Republicans—although some national strategists are still worried.

The dirtiest race is appropriately the one to succeed Jesse Helms in North Carolina, where both sides are spending a fortune on attack ads. The Democrat running for the Senate, Erskine Bowles, an investment banker who served as Mr Clinton's chief of staff, chose to “go negative”, and to some extent it worked; Elizabeth Dole's once huge lead is now in single digits. Still, the ever-smiling Republican should win.

The Republicans dream of picking up Louisiana (see article); and they have hopes that their Saxby Chambliss will oust Max Cleland in Georgia (a state that Mr Bush easily carried in 2000). Senator Cleland, a Vietnam veteran who goes down well with local military people, “unpatriotically” voted against the creation of the Department of Homeland Security. But he enjoys strong support from Roy Barnes, the popular Democratic governor, and from Zell Miller, Georgia's patriarch.

The South's particularly wobbly economy could destroy two Democratic governors. In South Carolina, Jim Hodges had hoped to announce that he was bringing a big DaimlerChrysler factory to the state; instead, the car giant has plumped for Georgia. Mr Hodges' Republican opponent, Mark Sanford, has a reputation for frugality that may match the times: while Congress was in session, the congressman slept on a futon in his Washington office.

In Alabama, another free-spending Democratic governor, Don Siegelman, is even more vulnerable. In 1999 Alabama voted down the lottery he hoped would provide money for education, and he has few accomplishments to counter charges from Bob Riley, his Republican opponent, that he has given no-bid contracts to friends. Still, remember that Alabama has had only two Republican governors since 1874 (which is two more than Georgia).

Yet, even if the Republicans are still doing pretty well, the Democrats are pulling back some white conservatives. One straw in the wind: Governors Barnes of Georgia and Siegelman of Alabama have both received the National Rifle Association's endorsement. Mr Barnes's Republican opponent was so cross that he challenged him to a skeet-shooting contest. Is the pragmatic Mr Barnes a possible vice-presidential candidate for 2004? As Bill Clinton showed, a moderate southern Democratic governor can

go a very long way.

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Louisiana's Senate race

Three against one

Oct 31st 2002 | NEW ORLEANS
From The Economist print edition

A popular Democrat challenged by a peculiar state rule

AP

Mary, quite contrary

IF SHE were seeking re-election anywhere else, Mary Landrieu would have nothing to worry about. Louisiana's junior senator, a Democrat, has carefully managed her votes in the Senate. She has a seat on the powerful Appropriations Committee. In every opinion poll she runs at least 20 percentage points ahead of her closest rival. But, because of the peculiarities of her state's election system, she could lose.

Unlike most states, Louisiana does not have primary elections in which the parties choose their candidates for the big fight. All those seeking this Senate seat face the voters on Tuesday. If none of them wins a majority, the top two meet in a run-off. If three Republicans can peel away enough votes to keep Ms Landrieu under 50% of the total, the showdown comes in December—when turnout may be low (which normally helps the Republicans).

Ms Landrieu's first Republican challenger was John Cooksey. The three-term congressman is a successful ophthalmologist, who has treated thousands of poor patients in sub-Saharan Africa. But he infuriated the White House by suggesting after the terrorist attacks that security officials should search anyone with “a diaper on his head and a fan belt around that diaper”.

Two other Republicans have entered the race. Tony Perkins, a member of the state legislature, is a darling of the Christian right. Louisiana's elections commissioner, Suzanne Haik Terrell, appeals to moderate Republicans who consider Mr Perkins too fervid and Mr Cooksey too tacky. Mr Perkins has dubbed her “Landrieu-lite”, but she is second in the polls.

Ms Landrieu's record is hardly that of a left-winger. She has supported George Bush's tax cut, the resolution authorising military action against Iraq, and a ban on one type of abortion. The scion of a prominent political family in free-wheeling New Orleans, she risked being attacked as a liberal; so her ads point out that she has voted with Mr Bush 75% of the time.

If there is a run-off in December, however, even this may not save her. That race will be the last occasion on which so-called “soft money”—money given to parties in general, not specific candidates—could be used. Since the Republicans probably have more in their pockets, this is daunting for a Democrat in a state where Mr Bush won handily two years ago.

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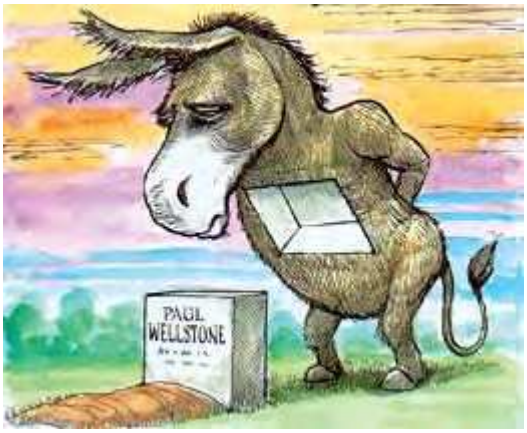
Lexington

After Wellstone

Oct 31st 2002
From The Economist print edition

A death that impoverishes the Senate



THERE was fulsome praise from fellow senators, of course, but something more. Tom Harkin, from neighbouring Iowa and one of America's vanishing breed of prairie populists, broke down in tears before he started a eulogy to his “best friend in the Senate”. From the other end of the political spectrum and the country, Pete Domenici, a conservative from New Mexico, could not, at first, deliver his tribute either. Paul Wellstone's death overwhelmed them both.

The Senate prides itself on stateliness. When grief disrupts its calm, you know something out of the ordinary has occurred. Mr Wellstone's death—in an aircraft crash in Minnesota, where he was desperately fighting to hang on to his Senate seat—was a particularly unexpected, gruesome affair: his wife and daughter also died. But the reaction showed something more. His death was a shock to the frail politics of conviction.

Mr Wellstone was the last of the 1960s generation of peace, love and anti-Vietnam-war activism in the Senate. The scion of a left-wing Russian Jewish family, he started teaching political science (rather suitably, in 1969) at a liberal-arts college, Carleton, in Minnesota. He was a typical rock-the-boat professor, organising sit-ins, leading a protest march on a local slaughterhouse and getting arrested for picketing a bank. After he won his first race in 1990, he offended against Senate protocol by talking about Minnesota's poor at every opportunity, abusing arcane voting procedures and leaving his battered campaign bus in other senators' parking spots. “The first time I saw him,” said Bob Kerrey, then representing Nebraska, “I thought he was a pain in the ass.”

Over time, he gained command of Senate procedures, won some friends among Republicans, but lost none of the stubbornness that made him vote his conscience, take risks and damn the consequences. He voted against missile defence, normalising trade with China, welfare reform, education reform and his own party's changes to the estate tax. Most of his work as a senator, he admitted, was “playing defence...rather than moving forward on a progressive agenda”. That may be one reason why Mr Wellstone was only a symbol for America's struggling leftists, never their leader. He was not a party man. He considered a presidential bid in 2000, but gave it up for health reasons.

It would be too much to say that Mr Wellstone's quixotic liberalism was unique. Russ Feingold of Wisconsin used to vie with him for the title of loneliest dissident, as measured by the number of times they voted against the majority in divisions of 99 to one. Nor did Mr Wellstone's politics strand him all alone in left-field. Although he probably had the Senate's most liberal voting record, Mr Harkin, Edward Kennedy, Barbara Boxer and Dianne Feinstein ran him pretty close. But nobody was so out-of-step with the increasing professionalisation of contemporary American politics.

That trend is taking two lurches forward in this year's mid-term elections. First, each party has taken enormous pains to disguise itself as the other. To insulate themselves against Democratic attacks, Republicans now want to subsidise the cost of prescription drugs, disavow plans to privatise Social Security and—it seems—lock up half of America's top managers for fraud. Democrats do not want to roll back tax cuts, and half of them are standing to attention behind President Bush's preparations for possible war in Iraq. Mr Wellstone had nothing to do with this. Alone among candidates in close Senate races, he voted against the congressional resolution on Iraq—an action expected to be politically suicidal,

but which actually seemed to increase his popularity. He proved that voters will respect a politician who votes his conscience, even when they disagree with him.

Lost: the Democrats' soul

The second dubious form of professionalisation is the increasing power of the party managers. The national committees have been descending on states with close races, buying reams of political advertising, interfering in campaign tactics and helping to spin the candidates' positions. The White House has been particularly blatant, rejecting local favourites and imposing candidates more to its liking (as happened in Minnesota). But the Democratic hierarchy has also wielded its cheque-book. Mr Wellstone did not like this. He sponsored a law—admittedly of dubious constitutionality—limiting "independent" political spending within 60 days of an election. "The Democratic Party", he complained in 1997, "has lost some of its soul."

It is true that the interfering, moderating party machines do sometimes get things right. By persuading the ethically challenged Bob Torricelli to remove himself from the ballot in New Jersey (and then replacing him with the popular Frank Lautenberg), the Democrats probably saved one seat. In Minnesota, where Mr Wellstone was running neck-and-neck with Norm Coleman, a moderate White-House-approved Republican, the Democrats have plumped for another elder statesman. Walter Mondale will gain from a high Democratic turn-out in the wake of Mr Wellstone's death. He shares some of Mr Wellstone's left-wing politics, but little of his quixotic idealism. Jimmy Carter's vice-president is far more the party insider.

So the politics of conviction are frail; but they are not hopeless, particularly if they have a human face. On one of his last days in the race, with Mr Coleman on the hustings every moment and the Iraq vote just around the corner, Mr Wellstone attended the opening of a centre to treat anorexic girls. He had met the family of a young woman who had died from the condition. His speech at the ceremony, shorn of any hint of campaigning, talked about the dangers of mental illness and of a bill before Congress to improve the way diseases of the mind are treated. "It'll pass at some point," he said. "We just need to make one more effort." But now Mr Wellstone isn't there to help.

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Brazil's presidential election

From pauper to president: now Lula's struggle really begins

Oct 31st 2002 | SAO PAULO
From The Economist print edition

EPA

Lula and his Workers' Party have learned to win power. Now they must learn to govern, and quickly

Get article background

AFTER his sweeping victory in October 27th's run-off vote, there are plans to make a film about the life of Luiz Inacio Lula da Silva, Brazil's president-elect. It will be quite a tear-jerker: Lula (as Brazilians know him) was born in the dirt-poor north-eastern backlands, one of 22 children of an illiterate farm worker, who beat them and sent them to work instead of to school. Aged seven, he made a gruelling, 13-day journey on the back of a truck with his mother and seven siblings, to join his father and his mistress and their children in a coastal town near Sao Paulo. He rose from shoe-shine boy to mechanic to leader of the Sao Paulo car workers' union, organising strikes that, in the late 1970s, undermined Brazil's military dictatorship.

Out of those strikes emerged the Workers' Party (PT), now Latin America's biggest left-wing party. After three failed presidential bids, last Sunday, his 57th birthday, Lula finally became the first working-class leader of the world's fourth-biggest democracy (and its ninth-largest economy), pledging to overcome, as he put it, Brazil's “historical legacy of inequality and social exclusion”.

A great story, so far. But how will it end? Lula's victory comes with Brazil's finances teetering on the brink of disaster. Fears that Brazil might follow Argentina's debt default, plus the uncertainty as to who would succeed President Fernando Henrique Cardoso, and mistrust of Lula himself, have all combined to trigger an investor panic that threatens to become self-fulfilling. The *real*, Brazil's currency, has lost 40% of its value this year, sending the public debt—much of which is linked to the exchange rate—spiralling (see chart 1). Since most of the public debt is held by local banks and pension funds, a default risks wrecking Brazil's financial system.

So the first question for Lula is whether he can restore financial confidence, and quickly establish trust in himself and his ability to govern. The signs are mixed. On the one hand, in this year's campaign, he put on a suit and tie, abandoned his old socialist

rhetoric and presented himself as “Lula: Love and Peace”. He pledged to control the government's finances and honour its heavy debts—instead of reneging on them as he once proposed. In August, when the IMF stepped in with a $30 billion loan package, he backed it. On the other hand, he continued making big spending promises: an end to hunger and homelessness; better pay for state workers; more aid to industry and to farmers big and small; more education and health care. He has aroused enormous expectations, and will struggle to meet them.

Still, in finally reaching the presidency, Lula has defied many forecasts of failure: many pundits argued that a former metalworker, lacking secondary schooling let alone a university degree, was unelectable in a basically conservative country. Although the economy has been weak for much of Mr Cardoso's second term, the president remained popular, for having tamed Brazil's chronic inflation and for bringing stability to its democracy. But in the event, Mr da Silva beat Jose Serra, Mr Cardoso's capable health minister, by an ample margin, of 53m to 33m votes. (Lula's total was just shy of Ronald Reagan's 1984 total of 54.5m, the largest-ever vote for a presidential candidate.)

Like other left-wing parties elsewhere (in Britain, Germany and Spain, for example), the PT set out on the road to electability when its moderate leaders plucked up the courage to curb its radicals. In March last year, Mr da Silva and his allies pushed through a change in the party's rules, so that the executive committee would be chosen by all members rather than by activists. The moderates duly strengthened their grip on the party machine, with Jose Dirceu, Lula's closest lieutenant, easily re-elected as party president.

His base secured, to the chagrin of the radicals, in June Mr da Silva struck an electoral alliance with the small, centre-right Liberal Party; one of its congressmen, Jose Alencar, a textiles tycoon (also born in poverty, like Mr da Silva) became his vice-presidential running mate. The more Lula incensed the PT's hard left, the more he reassured the voters. But their socialist pedigree gives Mr da Silva and his aides unchallenged authority over the party: during the dictatorship, Mr Dirceu was training in a Cuban guerrilla camp; in government, he is likely to be at Lula's side, perhaps as chief of staff. Another ex-guerrilla turned moderate, Jose Genoino, lost the election for governor of Sao Paulo state but is tipped for defence minister.

But Lula's only immediate appointment was to put Antonio Palocci in charge of his transition team. Mr Palocci was the campaign's rising star: he wrote the manifesto, and along with Mr Dirceu, acted as emergency spin-doctor whenever Mr da Silva, whose tongue sometimes has a life of its own, went “off message”. As mayor of Ribeirao Preto, a city of 500,000 in Sao Paulo state, Mr Palocci privatised some municipal services and brought businessmen into his administration. He is being tipped to control the federal budget as head of a beefed-up planning ministry.

Fiscal realism

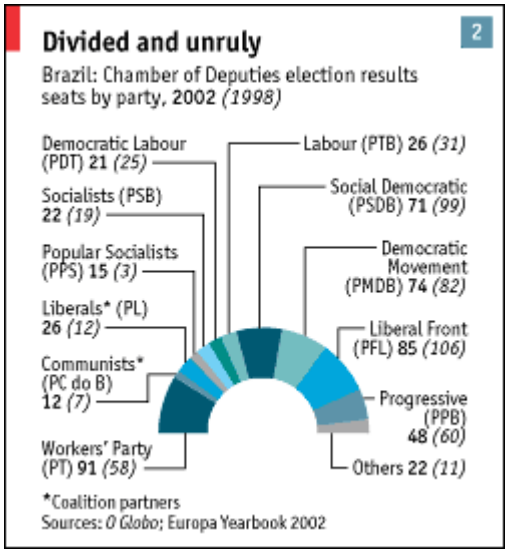
This week, Lula was quick to strike a note of economic realism. Warning that “there is no miraculous solution for such a huge social debt”, he said Brazil's dire straits demand “austerity in the use of public money”. As candidate, he assented to a tightening of Brazil's fiscal policy, as a condition of the IMF's loan. At present, this involves a primary fiscal surplus (ie, before interest payments) of 3¾% of GDP next year. In June, Mr da Silva said his government would be prepared to tighten further if necessary. This week Mr Palocci repeated that pledge.

To convince the markets of his determination to stabilise the public debt and avoid a default, Mr da Silva may have to deliver on this promise as soon as this month, when Brazil and the IMF hold their first review of the fiscal target. Raising it to 5% or even 6% of GDP may be the only way to inspire confidence. Then there is inflation: next year's target of 6.5% already looks hard, given the *real*'s plunge. Guido Mantega, Mr da Silva's economic adviser, has proposed raising it by one or two percentage points.

But this week, Mr Palocci insisted there were no plans to do so.

Besides economic targets, investors are anxious for names—those of the new economic team. Lula's failure to provide them caused markets to stutter again this week. But it may be several weeks before Mr da Silva, who does not take over the presidency until January 1st, announces his cabinet. That is because he must also try to put together a governing alliance.

Here, the omens are not promising. The election increased the fragmentation of Brazil's Congress (see chart 2). In his victory speech on Sunday, Lula admitted he and his party would need help to govern Brazil and promised to build a broad alliance of "all the good men and women of this country". His best option would be to clinch a centrist coalition with his main adversaries in the election, Mr Cardoso's Social Democrats (PSDB) and their partners, the catch-all Brazilian Democratic Movement (PMDB). This is not unthinkable: both parties, like the PT, had their roots in the opposition to the dictatorship.



But the PSDB and PMDB have both said that they are preparing for opposition, not government. They promised not to be reckless opponents, however. For much of the past eight years, the PT irresponsibly attacked Mr Cardoso's efforts at fiscal reforms, demanding more spending, regardless of affordability. Lula must hope the tables will not now be turned.

Despite the defeat of its presidential candidate, Mr Cardoso's alliance held on to many seats in Congress, and won most of the important state governorships. The PSDB alone will run seven states (out of 27), containing almost half of Brazil's 175m people, including the two largest, Sao Paulo and Minas Gerais. The PMDB's five states include Rio Grande do Sul, the fourth in importance, wrested from the PT after a governor from the party's radical wing ran a mediocre administration. The PT itself ended up with only three small states. Not only are governors powerful figures in their own right, but they often have sway over their states' congressmen.

Mongrel coalition

In the absence of a formal coalition with Mr Cardoso's support base, Mr da Silva has two options, neither especially palatable. One would be to seek a mongrel coalition spanning the left, assorted populists and bits of the conservative Liberal Front Party. The other, and most probable, would be to seek a looser "governability pact" between governors and president, an idea floated by Aecio Neves, the PSDB governor-elect of Minas Gerais.

Mr da Silva said this week that he would seek a consensus of this kind to press the outgoing Congress to approve much-needed tax reforms, plus a measure paving the way for central-bank independence. Congress is crucial, too, for efforts to stabilise the public finances. This requires spending cuts, especially in over-generous civil-service pensions. Mr Cardoso, despite a much stronger coalition, failed to gain approval for these (or at least, not enough of them).

Such cuts are all the more necessary since Mr da Silva says that he will start straightaway to fulfil his promises to fight poverty. He will seek to trim 6 billion *reais* ($1.6 billion) from existing spending programmes next year, in order to launch "Zero Hunger", an American-style food-stamps programme. But even if he achieves this, other promises, such as big rises in the minimum wage and in public servants' pay, will go unkept. Mr Dirceu admitted that the new government expects to face strikes and protests as a result.

To contain frustration at his inability to fulfil his promises in the short term, while pushing through difficult reforms to make them affordable in the future, Mr da Silva will need to show the great negotiating powers he boasted of in his campaign. At least, says Gaudencio Torquato, a political scientist at Sao Paulo University, he starts with the moral authority that his 53m votes bring: in his first few months, few politicians, from the PT radicals on his left to conservative parties on his right, will risk public censure by obstructing him. If he uses this opportunity well, the final reel of "Lula, the Movie" may yet have a happy ending. Otherwise, a horror film lies ahead for Brazil.

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Trade in the Americas

Clouds over Quito

Oct 31st 2002 | WASHINGTON, DC AND SAO PAULO
From The Economist print edition

Prospects for the Free-Trade Area of the Americas do not look good. Brazil's new president is only part of the reason why

OFFICIALLY, the cause of free trade in the Americas will take a firm step forward this week. At a meeting in Quito, Ecuador's capital, on November 1st, the United States and Brazil—along with Canada, the region's economic giants—jointly take over the chairmanship of the negotiations for the proposed Free-Trade Area of the Americas (FTAA). The 34 FTAA member countries (all those in the hemisphere except Cuba) will also agree on a raft of seemingly big decisions, such as clear timetables that aim to complete the talks by January 2005.

Unofficially, however, it is hard to find many people who are optimistic that the talks are going anywhere. Quito “creates the theoretical momentum, but the practical momentum is not there,” says a Brazilian official. Though the Bush administration trots out upbeat rhetoric, the mood among most trade experts is pessimistic. Few believe there is enough political will in the White House to push for a hemispheric trade agreement. As Brink Lindsey, of the free-market Cato Institute, puts it, the FTAA talks are “likely to be in permanent vegetative state”.

One reason for the pessimism is Brazil's new president. Luiz Inacio Lula da Silva and his Workers' Party (PT) have long been sceptical of the whole enterprise. The party manifesto says that the FTAA, as currently being discussed, is not a free-trade agreement but a process of “economic annexation” of Latin America by the United States. Only a couple of weeks ago, a very public spat erupted between Lula and Robert Zoellick, Mr Bush's top trade negotiator. Asked about Lula's concerns on the FTAA, Mr Zoellick pointed out that “no one is compelling Latin America to do anything”, adding that if the region wanted to trade with Antarctica, then Washington would pursue free trade elsewhere. Lula huffily responded that he would talk only to Mr Bush and not with some “sub-sub- sub-secretary” he had never heard of.

Diplomats on both sides have rushed to smooth ruffled feathers. In fact, the shift in trade policy that Lula represents can easily be exaggerated. Brazilians have long been dubious about the FTAA. And Lula has pledged not to take an “ideological stance” on the subject. Despite his contempt for Mr Zoellick's post, he has promised to create a similar one in Brazil (where trade talks have traditionally been handled by the foreign ministry). And he has sent an extremely moderate PT representative to observe the Quito meeting. There will be a “more assertive stance” on the FTAA under a Lula presidency, but no radical change, says Rubens Barbosa, Brazil's ambassador to the United States.

So far, the Bush administration has taken a harsh line in the talks, and especially with Brazil

While Lula's victory makes the negotiations slightly tougher, it is far from the only problem. The other big one is the United States itself. So far, the Bush administration has taken a harsh line in the talks, and especially with Brazil. The phasing-in of trade concessions is an example. The Americans have insisted, and the Quito meeting is likely to agree, that tariff reductions during the transition period towards full free trade should vary country by country. In global trade negotiations, in contrast, the “most favoured nation” principle normally applies, meaning that market access offered to one country must be offered to all. Mr Zoellick's argument is that small and poorer economies should receive preferential treatment. That principle is broadly accepted. Brazil complains, rightly enough, that it will be penalised. On the other hand, countries that already get preferential access to America's markets, especially those from the Caribbean and the Andes, naturally like the idea.

The biggest sticking point is agriculture. On this, the United States will talk only about greater market access, and even that reluctantly. The issue of trade-distorting farm subsidies, argues the Bush team, must be left for the global trade talks. The Americans have a point: it is hard for the United States to

forswear export subsidies in a regional agreement if the European Union, a much bigger abuser, is still using them. But that still leaves plenty of ways in which the United States could make a bigger effort for its FTAA partners, for many of whom agricultural exports are vital. One example is soyabeans, which are not produced in Europe. America's subsidies to its soya farmers hurt Brazil and Argentina.

As with soya, many other Latin American farm exports, such as sugar, cotton or orange juice, are politically sensitive in the United States, and the Bush team shows little sign of being willing to take on the vested interests involved. Negotiating lower trade barriers on sensitive farm products has been made harder by hurdles attached by Congress to its recent approval of the fast-track legislation required to clinch trade agreements. Worse, the United States is already trying to wriggle out of an agreement made with Mexico under the North American Free-Trade Agreement that allows unrestricted sugar imports by 2008. Nor does the political calendar bode well for completing the FTAA agricultural chapter by the January 2005 deadline. Almost 100,000 jobs in Florida, for instance, depend on the citrus industry. Is a real commitment to opening up that sector likely in a presidential election year?

Mr Bush's team is keen to cast the FTAA as a route towards hemispheric development and prosperity. The Quito meeting is supposed to set up a “Hemispheric Co-operation Programme”, where richer countries promise to help poorer ones deal with the talks and the adjustment they require. Most of the money is due to come from the Inter-American Development Bank. But Mr Zoellick will announce America's small financial contribution, no doubt with much fanfare. At the same time, the Bush team is pushing to hold next year's ministerial meeting in Miami. The rhetoric is all about how much America cares about the FTAA. American politics makes it hard to take that talk seriously.

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Politics in Venezuela

Desperate causes

Oct 31st 2002 | CARACAS
From The Economist print edition

The unbearable slightness of dialogue

Get article background

AN IMAGE of St Jude, patron of desperate and hopeless causes, gazes down on the crowd that since October 22nd has occupied a square in Caracas, Venezuela's capital, in support of a dozen dissident generals and admirals. The saint's help may be needed: the officers have sworn to stay put until President Hugo Chavez resigns and elections are called. But the president has so far declined to oblige. He rejects the dissidents' claim to be acting under a constitutional provision that enshrines the right to disobey a government that subverts democracy, arguing that they are engaged in a coup similar to one which briefly overthrew him last April.

Another who could use a miracle is Cesar Gaviria, secretary-general of the Organisation of American States (OAS). On October 27th, he arrived in Caracas for his third visit this year. His brief: to “facilitate” a dialogue between the government and the Democratic Co-ordinator, an opposition umbrella group. But the main agenda point that interests the opposition is setting a date either for early elections or for a referendum on Mr Chavez's presidency. Mr Chavez rejects both options. Even so, Mr Gaviria seemed optimistic that an agreement involving an early vote was possible.

After 45 months in office, Mr Chavez professes to be “consolidating” his “Bolivarian revolution”. He does seem to have arrived at what he always expected would be a final break with Venezuela's *ancien régime*. But it is the “revolution” that looks the more threatened. What Mr Chavez calls “the rotten elites”, the leaders of the traditional parties, trade unions, church and media, have banded together in a heterogeneous, sometimes quarrelling, but increasingly powerful coalition. And his bid to turn the armed forces into a political tool has merely imported Venezuela's political conflict to the barracks.

The dissident officers do not command troops. Nor do the scores of others who have joined their protest. If it were not for the crowd of civilians that surrounds the officers, which waxes and wanes but refuses to disappear, Mr Chavez might have tried to arrest the dissidents days ago. But that would be risky. A statement from anonymous middle-ranking officers gave warning that violence against the rebels would be met with violence.

Despite, or because of, the apparent success of the officers' protest, the Democratic Co-ordinator faces some hard decisions. So far, it has backed the rebel officers' cause, without itself demanding the president's resignation. Unless the Co-ordinator extracts government agreement to an early vote, it risks losing the initiative to the dissidents, whom the crowd treats like rock stars. But the officers, too, are taking a risk: if their protest fizzles, they will simply have aided Mr Chavez's purge of the armed forces.

By continuing to stonewall, Mr Chavez may buy some time. But he has lost the support of the majority of his country. From now on, it seems clear that his “revolution” can be imposed, if at all, only by force. That is something neither Venezuelans nor outsiders are likely to accept.

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Pollution in Canada

Contortions on Kyoto

Oct 31st 2002 | OTTAWA
From The Economist print edition

A country divided about greenery

TO MOST Canadians, the signs of climate change are all too obvious. Two decades of above-average temperatures have left prairie farmers counting crop losses from droughts. In the Arctic region, melting sea-ice and permafrost portend an altered life for northerners—and bring new anxieties over national security as new sea-lanes open up. A rise in summertime smog has brought an increase of asthma among children. This summer, when families escaped to their cabins beside lakes and rivers, they again found water levels far below childhood memories.

So Canada, it might seem, has every reason to back measures to halt global warming. Yet the Liberal government of Jean Chrétien, the prime minister, is struggling to win agreement among provincial premiers and even its own MPs to ratify the Kyoto Protocol on climate change by the end of the year, as he pledged to do at the Johannesburg summit in September.

Canada's decision is being closely watched. Although it produces only 2% of world emissions of carbon dioxide, its previous scepticism about Kyoto has provided some cover for the Bush administration's opposition to the protocol. But the issue splits Canadian politicians.

Canada's previous scepticism about Kyoto has provided some cover for the Bush administration's opposition to the protocol

For more than two years, the federal energy and environment ministers have been talking with provincial counterparts about how to reduce emissions to meet the Kyoto target (of 6% below 1990 levels). Since little concerted action has resulted, Canada now faces the task of achieving a 20% reduction by 2012. On October 24th the federal government finally produced a draft plan for how to do so. It leans heavily on industry, but also challenges every consumer (of transport, heating and much else) to save one tonne in five.

The plan was widely criticised for being unclear about the costs of emissions reduction. This week it was shot down when federal and provincial ministers held a special meeting on the issue, in Halifax, Nova Scotia's capital.

The opposition is led by Ralph Klein, the conservative premier of Alberta, Canada's main oil producer. He argues that Kyoto is a costly fiasco, and that the federal plan will land disproportionately on Alberta. Complying with it would jeopardise investment in the province's huge oilsands, at a cost of thousands of jobs.

Other provinces, such as Manitoba and Quebec, disapprove of Mr Klein's rollicking campaign. Manitoba uses much ethanol. Quebec relies on hydro power and, says Bernard Landry, its premier, has cleaned up its pulp and aluminium industries. Both provinces are in compliance with the Kyoto targets, and argue that they should not face further cuts.

But in Halifax these “green” provinces lined up with the oil producers to demand a revision of the federal plan—and a meeting of provincial premiers with Mr Chrétien—before Parliament debates the accord. Constitutionally, the provinces control natural resources and will have to implement most of the regulations.

Time-wasting “paralysis by analysis” complained David Anderson, the federal environment minister. But he said he will consult with the provinces, and come up with a revised plan at another meeting on November 21st. Mr Chrétien ruled out a premiers' meeting. Even so, this leaves only three weeks for parliamentary debate before the Christmas recess. Neither side has played its hand adroitly. Opponents

of Kyoto have woken up late. On the other hand, the federal cabinet, hampered by divided views, has failed to mobilise ordinary Canadians, many of whom are natural greens, on the issue.

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Trade in Asia

Every man for himself

Oct 31st 2002 | BANGKOK
From The Economist print edition

Slow progress on regional trade liberalisation in East Asia is prompting a spate of bilateral deals

TRADE in paper and ink, at the very least, must be booming in South-East Asia, given the number of commercial agreements the countries of the Association of South-East Asian Nations (ASEAN) are busily signing. On November 4th, at a summit in Phnom Penh, they are due to unveil a framework deal to achieve free trade with China by 2013. At the same time, they will make a declaration about strengthening trade with Japan, hold their first summit with India (with trade high on the agenda) and publish a report about integrating the economies of "ASEAN+3", which ropes in China, Japan and South Korea. Last week, America announced a new scheme to promote free-trade agreements with individual ASEAN members. Singapore and America hope to conclude the first such deal later this year. Singapore already has a free-trade agreement with Japan, while Thailand and the Philippines are negotiating ones of their own. And on January 1st next year, the ASEAN Free Trade Area (AFTA) will come into full force among the six original members of ASEAN: Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.

Ironically enough though, this frenzy of deal-making may actually signal a loss of momentum towards free trade in the region. To varying degrees, South-East Asian governments all accept the logic of cutting tariffs and promoting trade. As a relatively open, stable and low-cost manufacturing base, ASEAN used to attract much export-oriented investment. But the Asian crash of 1997, and the instability that followed, reduced the region's appeal, while investors stampeded off to ever more welcoming China. Since then, ASEAN governments have accelerated their effort to forge a common market among their 500m citizens, both to lure back foreigners and to discipline their domestic industries. AFTA, which caps intra-ASEAN tariffs at 5%, marks the culmination of this effort. Despite their consensus on the benefits of free trade, however, AFTA's members do not trust one another enough to streamline the current system, nor to negotiate collective deals with outsiders. Hence the bewildering array of overlapping protocols and compacts.

Take AFTA itself. Trade among its members has doubled over the past ten years, thanks in large part to tariff cuts. The main logic of cuts and the pact ought to be to consolidate the region's industries and thus

make them more competitive internationally. Yet the few exceptions to the tariff-cap regime are generally used to protect the most inefficient businesses. Malaysia, for example, refuses to bring tariffs on imported cars down until 2005 (and even then, only to 20%), in order to shield Proton, a local car maker. The Philippines caused a kerfuffle earlier this year by announcing that it would not lower tariffs on petrochemicals as scheduled, and might even add other products to the list. Textile manufacturers in Indonesia are now urging their government to do the same for them. And despite the fact that ASEAN's poorest citizens spend much of their income on rice, and the world's two biggest exporters of the crop (Thailand and Vietnam) are ASEAN members, rice will remain subject to higher-rate tariffs until at least 2020.

What's more, efforts to draw up shared procedures and standards for imports lag far behind tariff cuts—even though such non-tariff barriers constitute the biggest drag on trade in the region, according to a recent World Bank study. Nor is there any independent agency, akin to the European Union's commission, to adjudicate disputes between members. Indeed, AFTA has no enforcement mechanisms whatsoever: when Myanmar closed its border with Thailand for five months earlier this year, it did not even occur to the Thai government to invoke AFTA.

Some countries are growing impatient at these shortcomings. Singapore, for one, is pursuing multiple bilateral trade agreements, even with countries with which ASEAN is supposedly negotiating collectively, like Japan. Other ASEAN countries are following suit. Indeed, the group implicitly admitted that it couldn't agree on how to liberalise trade further earlier this year, when it decided to let individual members, or groups of members, press ahead without the rest. So Singapore, again, is now lobbying for an open-skies deal between willing AFTA members.

Even the new China pact will entail special exemptions and varying timetables for the different ASEAN members, albeit under a shared framework. Anyway, the deal comes more at China's initiative than ASEAN's. China first floated the idea two years ago—and sweetened it by offering to lower tariffs on agricultural imports from ASEAN within three years as a gesture of goodwill.

Of course, the deal is in ASEAN's best interests anyway: trade with China has grown threefold over the past decade, with ASEAN running a healthy surplus. This boom is helping to lessen South-East Asia's dependence on exports to America, Europe and Japan, which are stuck in the doldrums. The prospect of duty-free exports to China will doubtless persuade some of those flighty investors to return to ASEAN. The proposed free-trade area, after all, would be the world's biggest, with some 1.7 billion consumers.

The hope is that the benefits of even the initial “early harvest” of Chinese tariff cuts to be announced in Phnom Penh will inspire ASEAN to redouble the pace of integration and trade liberalisation. For much the same reason, America is also including duty-free privileges for certain imports from nearby bits of Indonesia in its planned deal with Singapore. But the effect, some fear, could be the reverse: such deals might deepen the divisions within ASEAN, and weaken its ability to bargain collectively with outsiders.

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North Korea

Just saying no

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And then what?

Get article background

NO ONE relishes the prospect of a nuclear-armed North Korea. But no one has worked out what to do about the prospect. On October 30th, Japanese diplomats emerged from their first proper talks with the North Koreans for two years to say they had asked them to scrap a nuclear weapons programme they owned up to last month in talks with America—but were turned down flat.

After their meeting at an Asia-Pacific summit in Mexico at the weekend, America's president, George Bush, Japan's prime minister, Junichiro Koizumi, and South Korea's president, Kim Dae-jung, all called on North Korea to “dismantle this programme in a prompt and verifiable manner”. North Korea's counter-demand is that America sign a treaty of non-aggression. Only then, said North Korea, somewhat vaguely, would it “be ready to clear the United States of its security concerns.”

North Korea knows that the weekend's publicly united front between America, Japan and South Korea barely conceals real tensions. South Korea's Mr Kim, with only a few months left in office, is desperate to pursue his “sunshine” policy with the lately less recalcitrant North Korea. Some of his officials have even cast doubt on America's version of what the North Koreans said in admitting to a previously hidden uranium-enrichment programme. The Japanese, for their part, want to press North Korea on the fate of some of the Japanese it now admits to kidnapping over the years, and to let the survivors and their children settle in Japan. However, Mr Koizumi has been firmer than Mr Kim in saying that relations with North Korea cannot be normalised and aid cannot flow until the nuclear issue is cleared up.

But a more pressing problem is what to do about a 1994 deal that until now has frozen North Korea's production of plutonium, from which bombs can also be made. After inspectors from the International Atomic Energy Agency (IAEA) had accused North Korea of illicit plutonium dabbling, America got no help from South Korea and Japan in confronting the regime. Instead America was left to negotiate a “framework agreement” that in return for the plutonium freeze offered North Korea two western-designed, less proliferation-prone power reactors (mostly paid for by South Korea and Japan) and interim supplies of oil (mostly paid for by America). The two reactors are now under construction. But for how much longer?

By secretly enriching uranium, North Korea has broken a denuclearisation agreement with South Korea and offended against the Nuclear Non-Proliferation Treaty and the IAEA's safeguards, and in doing all these things has breached the 1994 agreement too. While some opponents of the deal have long argued that it should be torn up, the Bush administration is still allowing the oil to flow. Sensible enough, while it consults its allies about how best to wean North Korea from its nuclear ambitions. But Congress is unlikely to vote more oil money without some nuclear give from North Korea.

Yet if America walks away from the 1994 deal by halting oil supplies, North Korea not only gets to keep its uranium, it also gets its hands on its “frozen” plutonium too. It thinks it has America over a barrel—and no doubt hopes it can still pick up aid from South Korea, if not Japan. Mr Bush has said he wants a negotiated outcome. But it is going to be tough keeping on speaking terms with everyone.

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Kashmir

A new broom

Oct 31st 2002 | DELHI
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But can the government bring peace?

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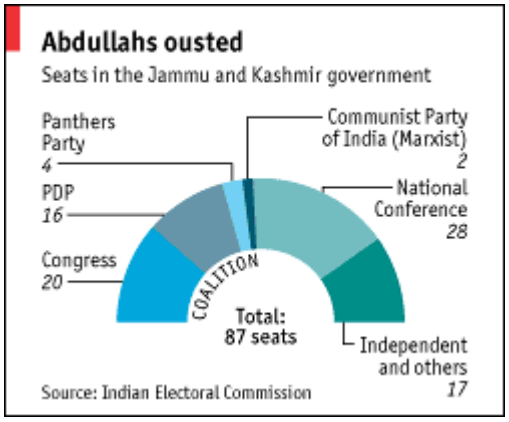

THE coalition government that was being formed this week in the north Indian state of Jammu and Kashmir is probably the best result that could have come out of the state's recent elections. Led by the People's Democratic Party (PDP), the government has a real chance of improving the lot of the Kashmiris, who have endured 13 years of insurgency and terrorism. Mufti Mohammad Sayeed, a 66-year-old veteran politician who is due to be sworn in as chief minister on November 2nd, calls it a “golden opportunity” for change. But delivering it will not be easy.

In the elections, which ended in early October, the PDP won only 16 of 87 assembly seats, so it will govern in coalition with Congress, India's main national opposition party, which won 20 seats, and other smaller groups including the intriguing Panthers Party. A Congress nominee will replace Mr Sayeed as chief minister half way through the assembly's six-year term—if the coalition lasts that long.

There are several reasons for optimism. First, there was a high turnout of about 44% in the polls, despite terrorist killings and opposition from neighbouring Pakistan; and there was little evidence of the vote rigging and coercion that marred elections in the late 1980s and 1990s. Second, the ineffectual National Conference, which has dominated Kashmir politics, mostly for the worse, for 50 years under the leadership of the Abdullah family, was decisively removed from power. That has cleared the way for a new approach with the PDP, supported by the clout of Congress, which has seized this chance to improve its image nationally, and especially with Muslims.

The PDP's strength stems from its support among Muslims in the Kashmir Valley, which lies at the centre of the troubles. It sympathises with the separatist groups which comprise the All Party Hurriyat Conference, though it does not call for independence from India. But Mr Sayeed will inevitably be accused of being soft on militants and there will be tensions both with coalition partners and with India's national government in Delhi.

Together with his daughter, Mehbooba, who is the PDP's most popular figure, Mr Sayeed recognises that his first task is to restore some semblance of good governance. In an attempt to sap support for militancy, he says he will not apply India's controversial Prevention of Terrorism Act, and will merge a hated Special Operations Group into Kashmir's regular police force. He will also look into releasing prisoners detained on minor charges—or on no charge at all—and will take action against security forces accused of atrocities.

The next step will be talks on repatriating constitutional powers from Delhi to Kashmir, which senior Indian government officials say they are ready to start. But progress will depend on the reaction of Pakistan, which has encouraged cross-border terrorism and keeps the Hurriyat on a tight leash—and so has the power to wreck Mr Sayeed's “golden opportunity”.

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Australia

When you're 64

Oct 31st 2002 | MELBOURNE
From The Economist print edition

Peter Costello eyes John Howard's job

Get article background

JOHN HOWARD, Australia's prime minister, must regret suggesting two years ago that he would consider his political future when he turned 64. With Australia united by grief after the terrorist bombings in Bali on October 12th that killed many young Australians, Mr Howard is behaving with an assurance that suggests the job is his for life. But after this mood passes, speculation will inevitably return about when Mr Howard, 64 next July, plans to step aside as leader of the Liberal Party to make way for Peter Costello, his most likely successor.

As Australia's treasurer (finance minister) and deputy leader of the Liberals, the senior partner in the conservative coalition, Mr Costello has presided over an economy that has grown strongly over the past five years, unaffected by slumps among its trading partners in America and Asia. A review in November is expected to show a slower growth rate for the 2002-03 financial year than the 3.75% forecast, but Australia still boasts the highest growth among rich countries.

Reuters

The challenger

Mr Costello signalled his thoughts on his future when he said in 1999 that he had “only one or two budgets left in me”. Last May's was the third, making a total of seven, more than most treasurers anywhere have been called upon to produce. Now, he says, “I don't find it getting any easier, I must say.” He is referring to his need to make bigger allowances for spending on defence and security, blowing away his surpluses—but there is also a sense of frustration in his remarks.

At 45, Mr Costello has had a dream run to the heights of political power accompanied by none of the setbacks that plagued Mr Howard over his 28-year political career. From his days as a law student in Melbourne in the 1970s, Mr Costello is remembered as one of the most politically ambitious figures of his generation. He is at one with Mr Howard as an economic dry, and has extended reforms begun under the former Labor government by modernising Australia's tax system. But on social issues, Mr Howard has pushed the Liberals and Australia further to the right; and it is here that cracks have appeared in Mr Costello's relations with his leader.

Mr Costello has declared his support for an Australian republic while Mr Howard has ensured that it stays constitutionally tied to the British monarchy. When thousands of people marched through Sydney two years ago in a symbolic walk for reconciliation with indigenous Australians, Mr Howard instructed Mr Costello not to take part. Mr Costello, whose Baptist upbringing still drives much of his outlook, was

furious. When a similar event happened later in his home town of Melbourne, he joined it. On October 16th, in the wake of the Bali bombings, Mr Costello declared that Australia was part of Asia, a stand with which the Anglophile Mr Howard has never felt comfortable. Mr Costello says that “we must heighten our engagement with the region”. That sounds like more than a finance minister talking.

Mr Howard will seek to avoid being pushed out in one of the leadership battles for which the Liberals are famous. But the media focus on the dynamics between the two men is likely to grow more intense. As Mr Costello says: “People think that because you've been treasurer for seven years you're only interested in economics. That's not the case with me.”

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Japanese politics

A winning woman

Oct 31st 2002 | TOKYO
From The Economist print edition

The main opposition party finds one new voice—but needs many more

HIROKO MIZUSHIMA broke into national politics two years ago after the opposition Democrat Party held a contest to find promising parliamentary candidates. Ms Mizushima, who was then a psychiatrist at Keio University hospital, wrote an essay about the need for change in Japan, with an emphasis on making life better for women. After impressing party members in face-to-face interviews, Ms Mizushima was chosen to stand for a seat in the Diet (parliament), and won. Lately, 34-year-old Ms Mizushima has been vetting candidates herself, seeking those who might improve the Democrats' sorry standing at the polls.

She has something that appears to be lacking among her fellow Democrats: a will to win. Her determination helped to give the Democrats their only victory on October 27th, when seven by-elections were held. The party's most promising candidate for a seat in Yamagata prefecture, Jun Saito, was under pressure from his family not to run. Ms Mizushima had a chat with Mr Saito's wife, who was pregnant, and persuaded her to back her husband. The Democrats were spared a humiliating shut-out at the polls. The ruling Liberal Democrat Party (LDP) won five seats, in a much-needed fillip for the prime minister, Junichiro Koizumi; an independent took the other.

Heartfelt appeals to spouses, however, are hardly Ms Mizushima's main or only strength. The success of her campaign two years ago was due to her strategy of wooing a wide range of voters, not only women. A young female candidate, she reckoned, risked alienating older male voters in her rural district with a direct approach. Instead, she took her campaign to the leaders of unions and other social groups. In the end, she won equal support from male and female voters.

The notion that candidates should seek votes beyond the party's core supporters is rare in Democratic circles. When Ms Mizushima interviews potential male candidates, she gets them to talk about the good things they plan to do for Japanese women. Her favourite question for female candidates is more blunt: How will you get middle-aged men to vote for you?

Ms Mizushima is trying to persuade the party's leaders that they need to do more to publicise the Democrats' policies, many of which favour women. The Democrats want a single, standard tax exemption for married couples, to replace an existing regime that dissuades many women from working full-time. The party also wants to reform pensions, to give women a greater sense of independence. Despite all this, polls by *Yomiuri Shimbun*, Japan's biggest daily, show that only half as many women as men back the Democrats.

One problem, says Katsuya Okada, who until recently headed the Democrats' policy committee, is that policies which appeal to career women tend to alienate those who stay at home. But Ms Mizushima argues that Japanese women do not fit into a simple dichotomy between serious professionals and traditional housewives. Women in rural districts such as hers have far more varied concerns than the party's leaders seem to grasp. Internal party polls taken earlier this year, which show that women of many backgrounds are unenthusiastic about the Democrats, seem to back her up.

So what should the Democrats do to win more seats? Ms Mizushima concedes that the party has to offer a compelling economic platform that will appeal to voters in general. But she is also urging her party to devote more energy to issues that appeal to specific groups of women. In pushing her ideas, Ms Mizushima has a big advantage. She knows how to win.

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China

Business under fire

Oct 31st 2002 | BEIJING
From The Economist print edition

A spate of arrests may be all about political jockeying

THESE are unnerving times for China's super-rich. In the past few weeks, the authorities have accused several prominent businessmen of economic crimes. With the Communist Party preparing to convene its five-yearly congress next week, politics has much to do with their troubles.

Several of the businessmen had close connections with leading political figures. The most prominent is the former head of China's State Power Corp, Gao Yan, who disappeared at the end of August. Mr Gao was a protégé of the head of China's parliament, Li Peng. Then, on October 10th, a court in Beijing sentenced another well-connected businessman, Zhu Xiaohua, to 15 years in prison for taking bribes worth $500,000. Formerly head of Everbright Group, a state-run firm that controls the country's sixth-largest commercial bank, Mr Zhu had been close to China's prime minister, Zhu Rongji, a rival of Li Peng.

Yang Bin, a Chinese-born Dutch citizen who was once one of China's richest men, was taken into custody in October on suspicion of land-use irregularities and tax evasion. He, too, had cultivated close ties with politicians, including Bo Xilai, the governor of Liaoning Province. An arrest warrant has been issued for Yang Rong, former head of Brilliance China Automotive Holdings, in connection with economic offences. He is believed to have fled to America. This week the Chinese media reported further on the fall of two more businessmen: Li Jingwei, the former chairman of Guangdong Jianlibao Corporation, a large state-controlled drinks company, and Sang Yuechun, former president of Changchun Jigang Group, a private property firm. Mr Li is accused of embezzling more than $400,000 from public funds, Mr Sang of involvement in racketeering. Both are said to have been stripped of their seats in the national legislature.

Part of the businessmen's troubles relates to a crackdown on tax evasion by the rich ordered by Zhu Rongji this summer, though cynics suggest that Mr Zhu was merely burnishing his legacy before his expected retirement next March. Anyway, almost any businessman in China is vulnerable on tax grounds, thanks to the labyrinthine complexity of the system. This is where politics comes in. Next week's congress will involve sweeping leadership changes. As the battle has intensified in recent months, protégés of those involved have been caught in the crossfire. Accusing an associate has often been used in Chinese politics to strike at an enemy. Perhaps not surprisingly, nobody closely linked to the party leader, Jiang Zemin—likely to remain a powerful figure even if he gives up all his party posts at the congress—has yet been targeted.

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Israeli politics

An end to unity

Oct 31st 2002 | JERUSALEM
From The Economist print edition

EPA

A gloomy Binyamin Ben-Eliezer leads his party out of Israel's government

Get article background

"WE SHALL continue to lead the nation, responsibly and wisely," Ariel Sharon assured the Knesset on October 30th, after his Labour Party partners had walked out of his 20-month-old government of national unity. Mr Sharon promptly sent his aides to sound out the ultra-nationalist National Union-Yisrael Beitenu block, whose seven seats would nudge his Labourless rump of 55 back into a majority in the 120-seat parliament.

Curious as it may seem to outsiders, in a narrow-based government of rightist and religious parties, members of Mr Sharon's Likud would play the role of the doves, with the prime minister himself as the leading moderate. But some of the hawks may balk. Avigdor Lieberman, the leader of Yisrael Beitenu (and a friend of Mr Sharon's foe, Binyamin Netanyahu), has said he will not join. Mr Sharon has already appointed Shaul Mofaz, the recently retired army chief of staff, as his defence minister in the place of the Labour leader, Binyamin Ben-Eliezer. General Mofaz was memorably recorded by an open media microphone last April urging Mr Sharon to deport Yasser Arafat in defiance of America's insistence that the Palestinian leader remain untouched.

If Labour's men had not jumped, Mr Sharon would have pushed them. He had given express warning that any party voting against the budget would be sacked. Constitutional convention was on his side. Nevertheless, on October 27th Labour's Central Committee ordered its ministers and members of the Knesset to vote against the budget on the 30th—unless the prime minister agreed to shift some $150m from the West Bank settlements to pensioners, students and single-parent families. Three days and nights of haggling failed to produce a deal.

Mr Sharon's men claimed that Mr Ben-Eliezer did not want one. They were probably right. The defence minister, a former comrade-in-arms of Mr Sharon, had been rattled by weekend polls showing him lagging behind his two more liberal rivals for the Labour Party leadership primary, scheduled for November 19th. The main plank in their campaigns was Labour's secession from the coalition government, where, they both contended, the party functioned in effect as Mr Sharon's lap-dog. They argued that Shimon Peres, the foreign minister, provided Mr Sharon's anti-peace policies with a patina of respectability abroad, but at the expense both of the party's principles and the Labour elder statesman's

own credibility.

By quitting, Mr Ben-Eliezer has made that plank his own, at least in theory. The dispute, over money for the settlements or for the poor, conveniently appeals both to the party's compromised ideological integrity and to its social conscience. But the beleaguered leader may have left it too late. His glum and deflated face on the Knesset podium hardly radiated conviction. Yet Mr Ben-Eliezer, and Mr Peres too, believe their presence alongside the prime minister in the inner policy-making sanctums has been a constant restraint on Mr Sharon's adventuristic streak, and generally on the militarism of the right.

Mr Sharon, by contrast, sounded vigorous and vindictive, lambasting Mr Ben-Eliezer for leaving on the day after two young girls and their woman teacher had been gunned down by a terrorist in a West Bank settlement. He, too, is gearing up to defend his leadership of his party against a challenge from Mr Netanyahu. Their tussle will take place ahead of the election, which will be held in November 2003 if Mr Sharon can keep going till then. If he can't, which is much more likely, an election can be called at 90 days' notice.

Mr Sharon will want to depict himself to his party's 300,000 registered voters as the unwavering defender of the settlements—even at the expense of the unity government, at whose head he has enjoyed high national popularity. Ideally, Mr Sharon would like to be able to put off the contest until after an American attack on Iraq, which, he vaguely feels, will improve Israel's situation and therefore his own. Strangely, Mr Sharon and Mr Ben-Eliezer both promise that if they win their respective primaries, and then lead their parties against each other in an election, whichever wins will invite the other into a government of national unity.

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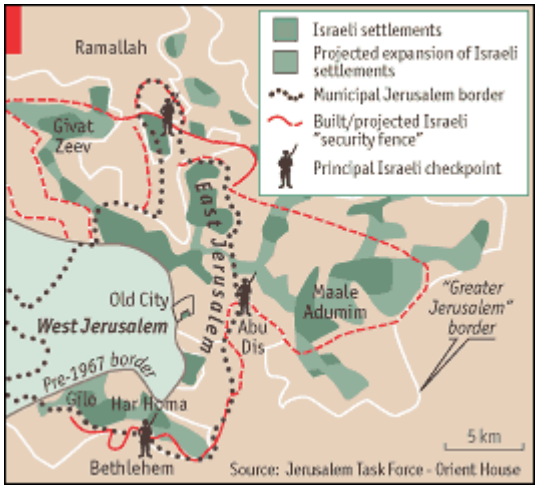
West Bank settlements

Swallowing all before them

Oct 31st 2002 | EAST JERUSALEM
From The Economist print edition

Despite the intifada, Israel intensifies colonisation of the West Bank

Get article background



KNOWING that it will take more than a cut in subsidies to reverse what they see as the gravest threat to their dream of a viable state, Palestinians were underwhelmed by the Labour Party's decision to leave Ariel Sharon's coalition over the money that the Israeli government proposes to spend on settlements. There are now 123 Jewish settlements in the West Bank, and 12 in occupied East Jerusalem, housing some 380,000 settlers who share the territory with 2.4m Palestinians. They do not share it equally.

According to a recent study by B'Tselem, an Israeli human-rights group, the West Bank settler population doubled in size during the seven-year Oslo peace process, and the settlements' territorial reach has now been extended to cover nearly 42% of the West Bank. This huge expansion has been achieved largely through the construction of settler-only bypass roads and military zones which serve to integrate the settlements with Israel proper.

What was interim during Oslo has become formalised during the *intifada*, says Yehezkel Lein, a B'Tselem researcher. Under the fire of conflict, settlements, roads and zones have in effect become Israel's new military borders in the West Bank, enabling the army to isolate Palestinian villages one from the other, and to reoccupy six of the eight main Palestinian towns.

The changes are most noticeable along Israel's northern border with the West Bank and around East Jerusalem, two areas Israel seeks to annex in any final settlement with the Palestinians. This is where most of Israel's settlement expenditure is being concentrated, says Mussi Raz, a member of the Knesset from the left-wing Meretz Party. Chunks of the northern West Bank have been cut off by the “security fence”—actually a grid of barriers, roads, trenches and sensors—that it is now being created along the pre-1967 border.

Around East Jerusalem, the fence is mapped to go even deeper into the West Bank. Palestinians fear that it will eventually envelop not only the East Jerusalem settlements (which the Israelis do not count as settlements as they long ago unilaterally annexed the city) but also vast urban blocks, such as Maale Adumim, in the West Bank. The result, they say, will be to cut off the 276,000 Palestinians in East Jerusalem and its environs from their West Bank hinterland. Moreover, the implantation of Jewish enclaves within the densely populated Palestinian areas in and around the Old City is being encouraged with government money.

This mixing of populations is presumably intended to prevent any return to the “understandings” on Jerusalem reached by Israeli and Palestinian negotiators, especially at the Taba talks in January 2001. It is, says Menachem Klein, an adviser to the Israeli delegation at the talks, Mr Sharon's answer to Bill Clinton's “parameter” that what is Jewish should be Israeli, and what is Arab should be Palestinian.

A similar logic appears to be behind the 100 or so settler

outposts that now pepper the West Bank, and whose “illegal” establishment Binyamin Ben-Eliezer, the Labour leader and departing defence minister, had at last decided to reverse. Begun as caravans on tops of hills, the outposts often develop into “legal” settlements.

Take Itamar, a settlement near Nablus. Home to fewer than 500 settlers, it has established seven outposts, some ten kilometres (six miles) beyond its built-up area. Earlier this month, the last families from the neighbouring Palestinian village of Yanun were forced to leave their homes after years of armed harassment from Itamar's settlers. It was the first full evacuation of a Palestinian village since the 1967 war.

The Palestinians ask for a full freeze on settlement construction as a first step to their evacuation or dismantlement. They presented this demand to William Burns, the State Department's special envoy, when he was in Jericho last week. Mr Burns is touring the region with the draft of a “roadmap” to resolve the Palestinian-Israeli conflict within three years. Among a slew of other demands, the roadmap calls for dismantling the outposts by December, and a freeze “on all settlement activity” by next May. But Palestinians believe that only a handful of the outposts will be removed, and Mr Sharon has consistently ruled out a freeze.

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Jordan and America

Murder, and its consequence

Oct 31st 2002 | AMMAN
From The Economist print edition

How safe an anti-Iraqi ally is Jordan?

FOR decades Jordan has prided itself on being the eye in the region's turbulent storm, immune to the political violence that marred its neighbours. No longer. On October 28th a masked gunman slipped into plush West Amman and killed Lawrence Foley, a 60-year-old employee on his last assignment with the American aid programme to Jordan. He was the first American diplomat to die by political violence since al-Qaeda bombed two American embassies in East Africa in 1988.

Mr Foley's assassination was also the first ever of a western official in Jordan. Nervous expatriates asked whether their planned evacuation in the event of an American strike on Iraq should now be brought forward. They take little assurance from the beefy patrols deployed to guard embassies. “The more protection given the big guys, the softer the targets will get,” said an American, worried whether his children should still use the school bus.

The American embassy vows it will not be swayed from its mission to develop Jordan into a regional showpiece of globalisation. Wedged between Israel and Iraq, the kingdom is seen as a vital link in any future pro-American Middle East. This year, America is pumping $450m into Jordan's army and economy, making the country of 5m people America's fourth-largest recipient of aid. To drive home that it was business as usual, the ambassador, Edward Gnehm, kept his appointment the next day to launch a Deutsche Bank equity fund for Jordan. But, unhappily, the killing came hours before the completion of Jordan's first big stockmarket privatisation, Jordan Telecom, prompting some investors to withdraw their offers.

An unconfirmed claim of responsibility came from a group calling itself the Honourable Men of Jordan. The group drew on a long list of anti-American grievances common on the streets of Amman, mostly to do with America's policies towards Iraq, Afghanistan and Israel.

King Abdullah constantly tells his people that they must think of their own country first. But Jordanians have many loyalties: more than half of them are Palestinian; and most of the rest have tribal ties to Iraq or Saudi Arabia. Three weeks ago, an American marine was killed in Kuwait, another Iraqi neighbour believed to be America's reliable ally.

There is unease in Jordan at who benefits from current policy. American largesse has been unsuccessful in sowing the promised dream of democracy. In the past five years, Jordan's exports to America have soared from $7m to an expected $400m this year. But, in the same period, parliament has been suspended, elections postponed and dissenting voices increasingly silenced. “Deprive people of their right to popular participation, and they will find other ways to make themselves heard,” said a leader of the still-legal Muslim Brotherhood, adding ominously that “violent struggle is a last resort.”

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Rebellion in Central Africa

No pay, no peace

Oct 31st 2002
From The Economist print edition

Yet another attempted coup in the Central African Republic

THE people of Bangui stockpile cassava in case of coups. This week, their foresight came in handy. Rebels occupied a northern chunk of the Central African Republic's capital on October 25th, and held it for five days before apparently being forced to retreat by the army and Libyan bombs. Wise folk are staying indoors and chewing their stockpiles.

The government is hanging on by its fingertips. This is the seventh bloody bid to remove President Ange-Félix Patassé from power since he was first elected in 1993. Without the help of Libya's Muammar Qaddafi, he is unlikely to have survived. Libya has backed his regime since last year, in return for a 99-year monopoly on extracting the republic's vast reserves of diamonds, gold and other minerals.

Reports suggest that the rebels are supporters of a popular sacked army chief, François Bozizé, a former Patassé loyalist with a grudge and presidential ambitions. Some witnesses say the rebels are reinforced by soldiers from Chad, a hostile neighbour. But reliable information is scarce: the presidential spokesman has been kidnapped, and the state radio is broadcasting little besides religious music.

The republic used to be much quieter. After the cannibalistic Emperor Jean-Bedel Bokassa was deposed in 1979, and before the recent troubles, it was quite a pleasant place to live. Though there were coups, they were efficient, French-run affairs with few casualties. But then France lost interest in all but the richest of its former colonies.

In the mid-1990s, France suddenly stopped paying public servants' salaries in the Central African Republic. This has had two effects. First, the bureaucracy is paralysed. To survive, many civil servants started growing their own food, which left little time for their official jobs. Ask an official to do something, and he may ponder, before getting up and fetching the relevant form, whether it is worth expending the necessary calories. Teachers and health workers, when not on strike, often demand bribes to carry out their duties.

Beware of hungry soldiers

The second effect is even more worrying. Military wages are a year or so in arrears. This makes soldiers jumpy: unpaid wages were a factor in the coup attempts of 1996, 1997 and 2001. The success or failure of the current insurrection may depend on how many of the government's men desert or join the rebels.

Other donors might have helped Mr Patassé with his wage bill, if only he were not such a tricky customer. After a previous rebellion, he sanctioned summary executions because, he said, God told him to. His friendship with Mr Qaddafi annoys the West, and his autocratic style annoys his parliament, which he did not bother to consult before signing away the country's mineral wealth to Libya. The regime still receives some aid, but donors complain that much of it is stolen.

With its fertile soil and abundant natural resources, the country should be prosperous. But investors are deterred by high taxes, opaque laws and chronic insecurity. It attracts freebooters and diamond smugglers, but not many reputable businesses. The Bangui Chamber of Commerce does not even have a telephone. Without much formal commerce, the state cannot levy much tax, and soldiers go hungry. Hence, in part, the current mess.

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Libya and the Arab League

Humbug

Oct 31st 2002 | CAIRO
From The Economist print edition

An Arab gift to Africa

Reuters

WHEN Muammar Qaddafi announced this week that he was pulling Libya out of the Arab League, he probably expected howls of protest at yet another blow to dreams of Arab unity. The move did send the league's secretary-general, Amr Moussa, scuttling to Tripoli to coax the Libyans back. But such is the current depth of pan-Arab gloom that the wider response was shrugs and nods of approval.

“It makes no difference because zero minus zero equals zero,” quipped Ahmed Ragab, an Egyptian humourist. The league is nothing but a club of impotents anyway, added a Saudi columnist. A toothless creature, said another, noting that the 57-year-old institution has proved incapable of stopping inter-Arab conflicts, let alone Israel's treatment of Palestinians, or American threats against Iraq.

Besides, Mr Qaddafi's criticism of his fellow Arabs is nothing new. Chagrined by their lack of support when Libya was placed under sanctions, he has increasingly shunned Arabs in favour of Africans. He helped to replace the old Organisation of African Unity with a new, ostensibly invigorated African Union. His foreign minister is now called the secretary for African unity affairs, and Libyan aid props up regimes such as Robert Mugabe's in Zimbabwe.

Much as ordinary Arabs fervently agree that their governments should act more forcefully and more concertedly, they are also weary of Mr Qaddafi's histrionics. His demand for an Arab army to liberate Jerusalem, for instance, might be taken more seriously if Libya had not itself neglected to pay some $80m it has pledged to the Arab League fund that supports the Palestinians.

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The future of the European Union

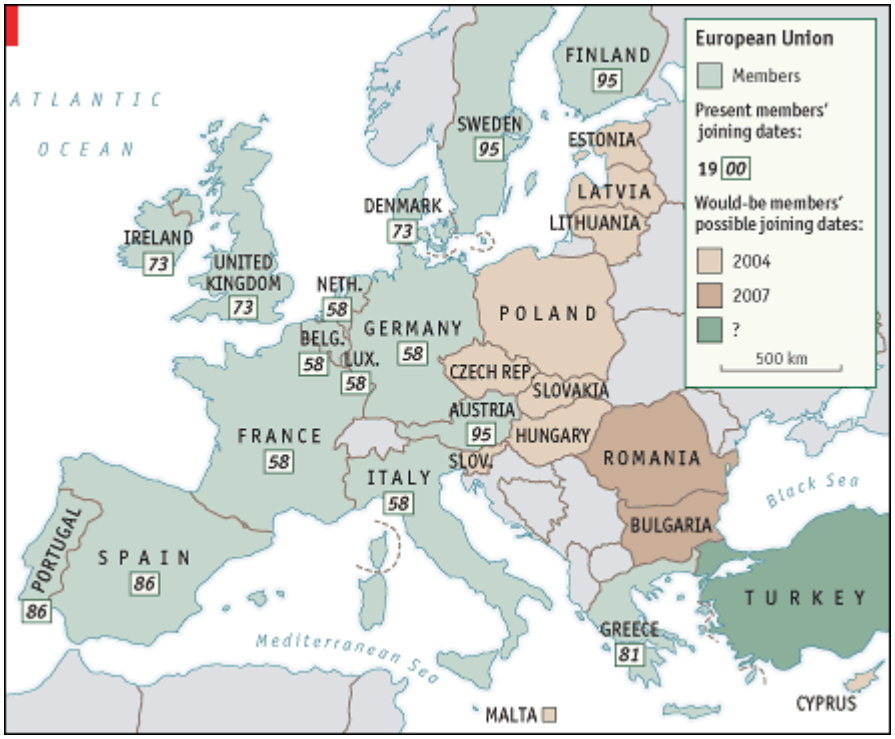
Can these bones live?

Oct 31st 2002 | BRUSSELS
From The Economist print edition

So far, it's just the skeleton of an outline of a draft of a may-yet-be EU constitution. But it may come to life

Get article background

HE'S a bit of a cadaverous figure himself, Valéry Giscard d'Estaing, the former French president dug out to head the group of Euro-notables charged with producing the first outline of a constitution for the new, soon-to-be-enlarged European Union. This week he offered its first results: “the skeleton”, not much more than a few general headings, of what he hopes for. Some strange anatomical features it has.



Mr Giscard d'Estaing wants the skeleton now to be fleshed out by the EU's more-or-less constitutional convention, over which he presides. Less, rather than more, in fact: modestly styled the “convention on the future of Europe”, its mandate from the EU's leaders is not itself to pass a constitution, but to offer ideas, both to overhaul the EU treaties and to bring the EU “closer to the people”, on which the EU governments can build.

Most of the 105 members of the convention are representatives from national governments and parliaments, from the 15 present EU countries and from countries that are currently negotiating to join the club. There are also two from the European Commission and 16 from the European Parliament. But this week's outline is, inevitably, the work of the inner 12-member praesidium of the convention. And, as inevitably, not all members of the convention are happy with it.

For a seemingly trivial start, should the EU change its name? The present treaties linking the 15 member states refer at times to the European Community (its former name), at times to the European Union. If the treaties are replaced, only one name will be necessary. The draft—while leaving it open whether to change at all—floats “United Europe” or “United States of Europe”. Ha, cry the Eurosceptics, proof of

schemes for a super-state; the British government has already expressed its dislike of any change.

The draft also proposes that every citizen of a member state would enjoy “dual citizenship, national citizenship and European citizenship, and is free to use either, as he or she chooses”. In practice, it seems, the two would be inseparable. The rights of an EU citizen depend on being a citizen of an EU country. Were a country to leave the EU—the draft suggests a clause permitting this—its citizens would lose their EU citizenship, willy-nilly. Eurosceptics think that this talk of dual citizenship yet again betrays an ambition to create a European super-state. But it may simply be evidence of woolly thinking.

These skirmishes over details are an indication of more serious battles to come, between those who want a strong centre at the heart of the Union and those who want to limit the power ceded by national governments. The latter are not united, however. To some sceptics, any constitution is anathema; others believe that one could halt the aspiration of the original 1957 Rome treaty towards “ever closer union”. One French member of the European Parliament calls the draft “the skeleton of a diplodocus, with an extremely small federalist brain and a huge intergovernmental body”. The question would be which part of the beast was really in charge.

For the moment, Mr Giscard d'Estaing has left open the question whether the European Council, where the member states are represented, should elect a long-term president, so strengthening the hands of the (larger) states, at the expense of the European Commission. Nor does the draft make clear what powers the EU, as distinct from its constituent members, would have in foreign policy, nor how those powers would be allocated between the commission and the council. The draft rather clumsily bundles EU competence for foreign and external security together with internal security.

The convention has to thrash these issues out before making recommendations next summer. And despite a passing reference in the draft to “liberty, security and justice”, Mr Giscard d'Estaing may also need to find some poetry to breathe life into the constitution's bones. Constitution-making by committee in 11 languages is not conducive to that. And yet the bones do hang together. Future generations of Europeans may look at the skeleton and see in it, not the relics of some extinct creature, but a crude, early, yet recognisable version of their days'*homo europaeus.*

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European defence

Well, they're talking

Oct 31st 2002
From The Economist print edition

All the same, a joint "European army" is still far away

YOU'VE heard the story about the French Gaullist, the Irishman, the Finn, the Greek-Cypriot, the Turk and a couple of dozen others who sat down to plan the defence of Europe?

Don't expect the punch-line yet, it hasn't been thought up. But among the plethora of groups of experts now puzzling out the future for a European Union of 25 states or more, few are as sensitive as the one chaired by France's Michel Barnier. As a member of the European Commission, his usual job is to dole out regional aid; but his musings on Europe's military future, and how this might be reflected in a revised EU treaty, are conducted in his personal capacity. He dreams of a European defence effort which is at once "in solidarity with America, and independent from America" and can be deployed either inside or outside NATO.

The EU is committed to some form of joint defence (and the draft less-than-constitution produced this week in Brussels makes explicit reference to it). But the idea rings so many alarm bells, both among neutral countries like Ireland and those of an Atlanticist tendency led by Britain, that Mr Barnier has begun by focusing his group's attention on facts that everyone can agree on. Since European spending on weapons and research is so puny, the Union is scarcely able to meet the targets it has already set—the ability to conduct a range of peacekeeping missions called the Petersberg tasks, and the capacity, by next year, to field a 60,000-strong "rapid-reaction force"—let alone set new ones.

As soon as serious discussions begin on how to correct this, however, which means very soon, sparks are bound to fly. Mr Barnier suggests lengthening the list of Petersberg tasks (so named for the German town where they were drawn up), to take account of the heightened risk of global terrorism and non-conventional weapons. He dreams of a robust new European institution (building on OCCAR, a low-key arms-buying agency which already exists) to manage arms procurement and research. In deference to the neutrals, he wants political arrangements that enable the keenest EU members to pool their defence efforts while allowing the squeamish to stay on the sidelines. Without involving the European Commission directly in defence decisions—a taboo for many members—he asks whether it could apply its experience to overseeing a "common market in weaponry".

Mr Barnier's hopes for an amicable division of labour between the EU and NATO, still a far more important defence club, rose this week after a diplomatic deal to finesse differences between Greece and Turkey. But how likely are the Frenchman's longer-term dreams of Euro-defence to be realised, either in the form of new treaty language, or in real military life? Daniel Keohane, of the Centre for European Reform, a think-tank, says the new EU constitution may well include a mutual defence guarantee—but in the form of a protocol rather than in the main text; that will make it easier for neutrals like his native Ireland to opt out. As for regulating the arms market, Mr Keohane thinks that the commission will never be allowed near it—but that could be a new role for the European Council, the body where member governments get together.

What about the much harder issue of giving Europe real firepower? Sir Tim Garden, a retired air marshal and critical supporter of Euro-defence, says Britain's interest in the project has been waning, because its EU partners have not done their bit. He reckons the formal aim of being able to deploy a 60,000-strong force might be achieved next year—by massaging the figures. But unless EU states spend far more on making such a force strong and sustainable (with high-tech communications, surveillance, transport and smart munitions), the long-vaunted Euro-army will hardly strike terror into its enemies.

The United States, meanwhile, has come up with an ingenious test of Europe's real interest in enhancing its firepower: a proposal for NATO to develop a small but very tough rapid-reaction force in which

European soldiers would be groomed to fight alongside American ones at their most lethal and sophisticated. The clear implication is that unless the Europeans grab this chance to close the transatlantic technology gap, they cannot have much serious interest in defence. And the EU's answer? None, so far: its members are too busy navel-gazing at institutions, constitutions and the like.

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Turkey's general election

Throw the rascals out

Oct 31st 2002 | ANKARA
From The Economist print edition

The old parties will be punished for their misdeeds. But then?

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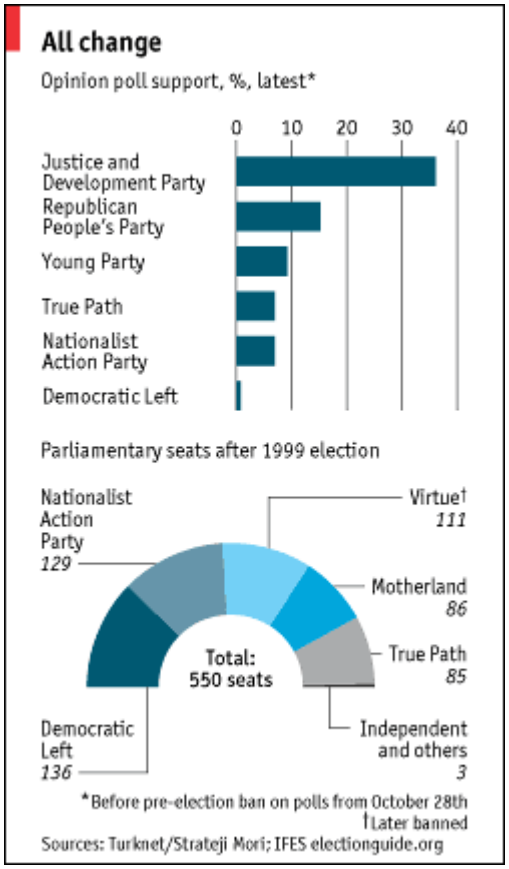

WHEN Turks go to the polls on November 3rd, many will not be voting for the man they deem most fit to lead them. They will be seeking to punish those who have mismanaged and plundered their country for decades and last year brought it to the brink of economic collapse.

"It is one of the most important elections in Turkish history," says Cuneyt Ulsever, a prominent liberal commentator and economist. "A whole generation of politicians will be buried at the ballot box." Opinion polls agree: of 17 parties contesting the election, only two, say the pollsters, are assured of winning the minimum 10% of the vote needed to win any seats at all. And the leader, by miles, is one that has never been in national power.

This is the Justice and Development (AK) Party of Recep Tayyip Erdogan. An ex-mayor of Istanbul, he himself has been banned from standing for Parliament, because he was once convicted of (supposedly) inciting religious hatred by reciting a poem to a public meeting. An Islamist, cry his enemies. His party indeed contains, and appeals to, many of seriously Islamic bent. But its big appeal is that it is seen as uncorrupt. The banned Mr Erdogan has not named his party's substitute candidate for the prime ministership, to the wrath of Turkey's president. But voters do not seem to care.

Number two, say the pollsters, is Deniz Baykal's Republican People's Party, founded by the father of the nation, Kemal Ataturk. Many secular-minded Turks will back it essentially to check the rise of Mr Erdogan. But many more will do so because of another fresh face: Kemal Dervis, the former economy minister who pulled Turkey back from the precipice last year, is running on the Republican People's ticket. He is seen as the one man who can keep the economy on track, and the economy is what concerns voters most.

In contrast, the Democratic Left Party of Bulent Ecevit, the prime minister, who has been around for nearly four decades, and who is blamed for the economic trouble, is expected to score well below 5%, let alone 10%. So is the Motherland Party of Mesut Yilmaz, which has shared power in most Turkish governments since the generals' last coup, in 1980.

So too, however, is Felicity, the latest incarnation of a series of openly pro-Islamic parties banned over the past four decades. So much for the generals' mantra that Islamic fundamentalism is a big threat to Turkey. And try as they do to pin the Islamist label on Mr Erdogan, it has not stuck. He has wisely refrained from fielding women candidates in headscarves; the Virtue party, Felicity's predecessor, did so in the last election and got banned. His list is a mixture of yuppies, academics and former bureaucrats, besides old friends who, as he did, started their political careers in the Islamic movement.

"I don't feel in the least bit threatened by him, even if he comes to power on his own," says Ishak Alaton, a prominent Jewish industrialist. The only risk he sees in an outright AK majority—which could happen—

is the risk to democracy posed by the army's distrust of Mr Erdogan.

Indeed, Turkey's top businesspeople, and their western friends, would be happy with an alliance between Mr Erdogan and Mr Baykal. And the two seem ready for one. In a televised debate last week, they were mainly in agreement, whether on the need to pursue Turkey's IMF-sponsored recovery plan or to carry out all the reforms needed to join the European Union.

So far so good. Not so good is the news from the pollsters that the third party that may get over the 10% hurdle is the “young” party of Cem Uzan, a jingoistic media tycoon whose promises of jobs, free land, and booting out the IMF have won him wide support among the urban poor. And the hurdle itself—for all its good intentions of getting rid of micro-parties—is not good news at all. The coming election could leave a seriously large proportion of Turkey's voters with no representation in the new parliament whatever.

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Norway's politics

One very popular populist

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From The Economist print edition

Right now, voters love Carl I. Hagen, the maverick of Norwegian politics

HE IS on a roll. Before last September's general election, the populist, free-marketeering Progress Party of Carl I. Hagen was being written off as a spent force, after a string of sex scandals and internecine feuding. In fact, it won 14.7% of the vote: a respectable score, but a little down on its 1997 figure, and far below some of its opinion-poll scores in the years between. Yet a poll last week gave it 36.3%—while, between them, the three parties of Norway's government scored only 23.7%.

How has it come about? For a start, says Bernt Aardal, professor of political science at Oslo University, Mr Hagen's party is the one that vacuums up voter discontent. And Norwegians are not happy at this moment. They feel let down by a government that promised tax cuts but failed to deliver. Mr Hagen, meanwhile, has both pandered to anti-immigrant sentiment and cast himself as the defender of the creaking but familiar welfare, education and health systems: in sum, here is the defender of the Norwegian way of life.

And just as he once put on a decent performance as a tightrope walker in a circus some 15 years ago, Mr Hagen has learned to keep his footing in parliamentary politics. The minority centre-right government formed after the 2001 election by Kjell Magne Bondevik needs the Progress Party's votes to stay in power. It usually gets them—but not always. “The Progress Party is both part of the power structure and outside it, and this has boosted Mr Hagen's popularity,” says Professor Aardal. The party claims it has been enrolling new members at the rate of 600 a month.

The immediate trigger to the surge seems to the 2003 budget. The government presented a draft in early October. The prime minister said he would increase spending on health care, child care and foreign aid, but would not cut income taxes. Mr Bondevik, a teetotal Lutheran priest, also declined to reduce Norway's enormous levies on alcoholic drinks.

Mr Hagen says the people can have their tax cuts, cheap booze, better highways, more prisons, affordable cars and fewer alms-seeking immigrants. All the government has to do, he says, is spend a little bit more, say 10 billion kroner more ($1.33 billion), of its huge “petroleum fund”. This fund, which is expected to reach almost $90 billion by the end of this year, is where the state stashes the proceeds of its North Sea oil output. For 2003, the government is already planning to dip into this piggy-bank to make up a $4.6 billion budget deficit. But no more than that, it says: it is worried about inflation, the international competitiveness of the economy and depreciation of the krone.

Whether it is right or wrong, this macroeconomic argument does not cut much ice with ordinary Norwegians. They think the government is just being mean. Whether they will go on backing Mr Hagen as far as the next general election, in 2005, is another matter. In Norway, as elsewhere, between elections discontented voters may express their woes forcefully through opinion polls, but when a real election comes round, they tend to revert to their familiar party preferences.

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Kosovo voting

Inching forward

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From The Economist print edition

A Serb boycott frustrates the UN

IN THE political jargon of NATO-occupied Kosovo, the letter “i” stands for two things: one is independence—which is the only political status for the province that its ethnic-Albanian majority want to talk about; the other is “internationals”, a catch-all term for the soldiers, bureaucrats and aid workers who have looked after the place since Yugoslav troops were forced to pull out in the summer of 1999.

Much as Kosovo's ethnic Albanians wish it were otherwise, their hopes of progress towards the first big “i” are dependent, at least in the short term, on satisfying the requirements of the second. Michael Steiner, the German diplomat who oversees the province for the United Nations, has told the Albanians that political developments will hinge on their ability to administer their local affairs, and to co-exist with minorities, in a civilised way—and it is those pesky “internationals”, of course, who will be the judges of what constitutes civilised behaviour.

For Kosovo's foreign protectors, the local elections on October 26th, in which a respectable 57% of the Albanians eligible to vote took part, seemed like a step in the right direction. Over the next few years, an increasing amount of power over municipal affairs will be transferred from the province's UN masters to local institutions. And the more sophisticated among Kosovo's Albanian politicians seem to have got the message that good conduct, including decent treatment of all ethnic groups, will ultimately bring dividends.

Less encouraging, from Mr Steiner's point of view, was the local Serb minority's frosty response to his repeated warnings that voting in the election was the only way for that embattled community to have some stake in Kosovo's governance.

In messages to the 90,000 Serbs who still live in Kosovo—and the 230,000 non-Albanians (mostly Serbs) who have fled the province—Mr Steiner all but begged them to go to the polls. Vote, he told them, and you will benefit from a plan to devolve power to local authorities, including Serb-dominated ones; there will be increased economic investment in the blighted NATO-guarded enclaves where many of Kosovo's Serbs now live. Don't vote, and you're consigning yourself to four years in the political Dark Ages.

In the end, Serb turnout was dismally low, at around 20% of those entitled to cast ballots. In the ethnically-divided northern city of Mitrovica, out of a total of 65,000 registered voters only 54 Serbs voted. The international bureaucracy's plans to decentralise power and encourage investment have for now been shelved.

A series of confused messages from nationalist Serb politicians in Belgrade and Kosovo may be to blame for the poor showing. In any case, the fact that Kosovo's Serbs have apparently committed political hara-kiri by staying away from the polls will greatly complicate Mr Steiner's effort to raise money at a donors' conference in Brussels next week. He will be looking for nearly *euro*40m ($39m) to pay for a programme of “sustainable returns” under which the Kosovo Serbs sheltering outside the province can gradually be induced to go home.

But Mr Steiner will not easily be dissuaded from his plan to promote inter-ethnic co-existence in his fief. An accomplished trouble-shooter and veteran of the Balkan wars, he has staked his reputation on his ability to transform the province, using every political and economic trick in the book, into a slightly more decent place. Brave man.

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Spain's party politics

The Socialists see a way ahead

Oct 31st 2002 | MADRID
From The Economist print edition

After years out of national power, they have a plan for a comeback

EPA

Relaunching Zapatero

SINCE 1996 they have been in the political wilderness. Now Spain's Socialists see a chance for a comeback, first in next spring's regional and municipal elections, then in the general election of 2004. You could itemise their plan like this:

One, rehabilitate your veteran leader and former prime minister, Felipe Gonzalez, while relaunching his youthful successor, Jose Luis Rodriguez Zapatero, as the challenger for the prime ministership at the next general election, due in the spring of 2004. Do this at a mass rally, held on October 27th, to commemorate the 20th anniversary of your landslide victory in 1982—the first time a left-wing government had come to power since Francisco Franco's uprising in 1936. And do it a full year before the current prime minister, Jose Maria Aznar, who has announced he will step down in 2004, when his second four-year term ends, names his successor.

Two, have Mr Gonzalez, who still exerts charismatic pulling power over the older party faithful, endorse his heir. But ensure that Mr Zapatero denounces the corruption that brought 13½ years of Socialist rule to a messy end. (Spain's present rulers are pretty tacky too, Mr Gonzalez growled in a joint television appearance with Mr Zapatero. That's no excuse, retorted the younger man. We're Socialists—people did things, in your days of power, that they shouldn't have done and they'll certainly not do them in mine.)

Three, insist that there are differences, yes, truly, between your party and Mr Aznar's centre-right lot. But mention none that might reek of old-style socialism or alienate voters who approve of Mr Aznar's tougher controls on immigration and hard stand against the Basque terrorists of ETA.

Four, make it clear that, even so, you would have a cuddlier style of government: less harsh in its rhetoric, less autocratic, more welcoming to those immigrants who are allowed in—and while you won't raise taxes, you'll certainly introduce a fairer system of taxation.

Five, insist you favour greater European integration and have no problem with the concept of a federal Europe.

Six, avoid rabid attacks on the government. They can make you look bad. But say you won't appoint your mates to top jobs in recently privatised industries or exert undue influence over public television, thus implicitly accusing Mr Aznar of doing both these things.

Seven, make friends. Send Mr Zapatero to visit Tony Blair and annoy Mr Aznar, who had appropriated the British leader as his chum. But stress that Spain is different: that while there's much that you approve of in Mr Blair's “third way”—concern for public safety and good policing, for instance, which no one should think a prerogative of the right—there are other things you don't like, such as private-sector funding for public projects.

Eight, raise hopes among the powerful “nationalists” of Spain's regions that you would be nicer to them than Mr Aznar is. And that, while you are as tough on ETA as he is, you'd certainly chat more to the non-violent Basque nationalists, which might, just, make peace in that region easier.

Nine, persuade the party's ageing and stroppy regional premiers to keep their criticisms to themselves. Create at least an image of unity in the run-up to regional and municipal elections next May.

Ten, insist—in public—that you can win national power in 2004; argue that polls show support for Mr Aznar has peaked and that his lead is narrowing. Admit, in private, that denting the centre-right's majority would be a pretty good start, thus ensuring your own leader can survive defeat in 2004, if it happens, to fight another day.

And then keep your fingers crossed.

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Charlemagne

The summits of desire

Oct 31st 2002
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Not much longer will EU summits flit from resort to resort. But one old habit lives again: the Franco-German axis

AN AIR of gloom hung over the thousands of journalists and officials assembled in Brussels last week for a European Union summit. It was not because the 15 EU leaders had agreed once again to put off reform of the EU's bizarre and wasteful system of agricultural subsidies. It was not the haggling over the costs of enlargement, nor the unseemly row between Jacques Chirac and Tony Blair, nor even the prospect of war in the Middle East. These were worrying developments, no doubt. But the real cause of all the angst was the realisation that the great Eurosummit gravy train has stopped rattling merrily around the Union and has pulled into a permanent siding in Brussels.

One of the pleasanter aspects of living in Brussels and following the EU has, till now, been the regular opportunities to leave the Belgian capital. EU rules put a different country in the presidency every six months. That has meant up to four summits outside Brussels each year. And since every country is keen to display itself in its best light, they are usually somewhere nice: Barcelona, Biarritz, Rome. For journalists the routine is well established. Arrive at cavernous press centre, unpack lap-top, go off in search of bag of free gifts usually containing a sample of local craft-work and a bottle of alcohol; unlike their American counterparts, European journalists are generally not inhibited by tiresome scruples about accepting hospitality. Meanwhile the officials and ministers haggle, and then emerge after a couple of days to give simultaneous press conferences, usually involving a triumph for their own country and/or the European ideal.

But this happy tradition is now coming to an end. At a summit in Nice at the end of 2000, European leaders agreed that one in every two summits would henceforth be held in Brussels; and that once the Union had expanded to 18 countries—it now expects to reach 25 in 2004—all summits would be held in that often gloomy and rainswept city. It looks as if a summit in Greece next spring (or, on present form improbably, a later one in Italy) will be the last hurrah for the EU's travelling circus.

There are both good and bad reasons for this change. The respectable reason is that once the EU has 25 members the whole road-show will become impossibly unwieldy and expensive. There is also an argument that migrating summits produce an unhealthy activism, as each summit-host strives to produce an eye-catching new policy. But the real reason that all summits have been moved to Brussels is much less logical. At the Nice summit, where the decision was made, the Belgians threw a fit because their Dutch neighbours were given one more vote than they were in the EU's byzantine voting structure. That was wholly reasonable: the population of the Netherlands is more than half as large again as that of Belgium. But a tasty piece of pork had to be dangled in front of the Belgians to buy them off. Hence the late-night offer to move all future summits to Brussels.

Plus ça change

The first of the new-style Brussels summits, however, got off to an old-style start. Before it began, the leaders of France and Germany got together and stitched up a deal, which was then presented to the others as a fait accompli. This used to be how things were done. In recent years, however, the “Franco-German motor” has been sputtering. The two countries had a nasty show-down at the Nice summit in

2000, and have been haggling ever since about farm reform and the costs of financing EU enlargement. This time, however, Jacques Chirac and Gerhard Schröder repaired to a posh hotel and struck a deal. The Germans abandoned their insistence on immediate reform of the EU's farm policy, in return for a French promise that its cost would be capped from 2007 on, at the 2006 level plus 1% a year. That was a potentially significant French concession: since the new members are heavily agrarian, under current rules the cost could have risen sharply, and France may lose a good deal when they are altered to keep the cost down.

There was no disguising French satisfaction at this apparent restoration of the old order. At a closing press conference, Mr Chirac smiled broadly and announced that the deal showed that “if there is no Franco-German accord, Europe grinds to a halt.” The British were correspondingly bad-tempered, insisting with little conviction, and less persuasive force, that farm reform remains on track, but clearly aghast that Tony Blair's pretensions to leadership in Europe had been punctured. He seemed unusually flustered, and skipped the closing British press conference; it later emerged that he and Mr Chirac had had a nasty row.

Still, France (with Spain, notably) will indeed see its farm subsidies shrink. However, according to the figures doing the rounds in Brussels, the real losers, predictably enough, will be the candidate countries. By 2013, the levels of “direct payments” to their farmers are due to rise to the same as those in the present EU countries. Yet projections from the European Commission show that even then the newcomers' farmers will receive a paltry *euro*5 billion a year (about $5 billion at today's rates) in direct payments, while those of the current members will still get *euro*45 billion. There are various tortured justifications for this unequal share-out, to do with comparative production levels and prices in the new countries. But given that the applicants are much poorer than current members, and mostly have much larger agricultural sectors, the division of spoils still seems a mite unfair.

In theory, the applicants can argue for a better deal before the next EU summit in December, when the final details of their accession are due to be nailed down. And, once inside the EU, they will be entitled to their say on farm reform like any other member—a nasty thought for less rural countries. But, for now, the candidates have little option but to accept whatever is on offer, however lousy. In this respect, the Brussels meeting conformed to the tradition of all EU summits: it is always easiest to strike a deal at the expense of those who are not in the room.

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Competition policy

Setting the trap

Oct 31st 2002
From The Economist print edition

American-style trust-busting powers are coming to Britain

“OUR competitors are our friends, our customers are the enemy.” That succinct comment by an American businessman, secretly recorded by an FBI whistle-blower, led to long jail sentences for two senior executives of Archer Daniels Midland, an American agribusiness giant that had conspired with its rivals to keep prices up. Now Britain's trust-busters are set to gain similar powers to bug and raid.

Compared with America, where billion-dollar fines are handed out and executives jailed, British executives have got off lightly. The outfit responsible for rooting out cartels, the Office of Fair Trading (OFT), was for years a cash-strapped Whitehall runt. It was American, not British, investigators who cracked the cartel between the world's grandest auctioneers, New York-based Sotheby's and London-based Christie's. Until 1998 British companies that fixed prices risked no more than a slap on a wrist.

The Competition Act of 1998, which came into force in 2000, gave the OFT some new powers. It can now levy fines (of up to 10% of turnover) on companies engaged in anti-competitive behaviour. And, as in America, it can offer immunity from prosecution to cartel members who co-operate with the authorities. That puts a premium on speedy disloyalty to the cartel. This clever use of game theory has led to 14 British companies gaining immunity from civil prosecution.

But these new powers do not so far seem to have had much impact. Fines earlier this year on two bus companies, Arriva and FirstGroup, for a carve-up of routes in Yorkshire, were reduced from £850,000 ($550,000) to just over £200,000. The only other fine imposed was for an obscure conspiracy involving brake parts. A lengthy investigation into milk supply in Scotland has just finished with the conclusion that despite “grounds for suspicion” (“it stinks” in bureaucracy-speak), there was not enough proof of a cartel.

Maybe Britain's trust-busters have dug up little dirt because there is little to be found. If so, that would make Britain an amazing global exception. The European Commission has imposed fines on nearly 20 cartels, involving nearly 100 companies, in the past two years. Despite recent American successes in cartel busting, Joel Klein, a former assistant attorney-general, has said this is only a small part of an iceberg of anti-competitive activity. A recent international seminar of competition authorities listed more than 30 industries as worthy of investigation, ranging from shipping to diamonds. The OECD, which praised Britain's competition policy in a report published on October 24th, does not think Britain cartel-free: it says that, in the industries that have been investigated, the presence of cartels keeps prices, on average, 20% higher than they should be.

A new Enterprise Bill should help to change that. The bill, now going through Parliament, aims to sharpen up Britain's competitiveness in a number of ways—by, for instance, taking power over mergers out of politicians' hands. But the measures that have caused most interest and alarm are those which will beef up the OFT. When the bill becomes law, it will be able to bug businessmen, tap their phones, intercept their e-mails and spy on them. Prior to 1998, company directors caught breaking competition law faced nothing worse than a reprimand. In future, they could be jailed for up to five years.

Adam Smith would not have approved. Although the best-known passage in his “Wealth of Nations” says that “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices,” he then issues a less familiar warning: “It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice.”

Some lawyers echo these thoughts, doubting whether the OFT's new criminal powers will do what they are supposed to. Criminalising cartels will involve companies and the OFT in a procedural jungle risking years of delay, says Diana Good of Linklaters. Stephen Tupper of Hammond Suddards Edge fears that making cartels subject to criminal law may be a sledgehammer to crack a nut.

Some politicians agree: the bill has had a troubled passage through Parliament. But its most important provisions have survived; and they will make indulging in dodgy business practices in Britain a great deal more dangerous than it used to be.

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BP

Brownian motion

Oct 31st 2002
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Britain's top oilman, Lord Browne, is uncharacteristically embarrassed

OOPS. For a man who likes to get everything right, Lord Browne's admission this week that his oil company, BP, had repeatedly got its sums wrong was as galling as it is unusual.

Instead of raising production of oil and gas this year by 5.5% as promised, BP said it would in fact manage only 3%. That was the third downward revision in the space of eight weeks. Lame excuses made it even worse. A company with one of the best planning and forecasting systems in the world claimed to have been caught out by storms in the Gulf of Mexico and a litany of tiresome problems with equipment elsewhere. None of these seem to have bothered other oil companies much, and they do not fully explain the shambles in communicating the shortfall.

The real problem—admitted even inside the company—is that BP has been too ambitious. “I think he got a bit carried away. He wanted to make the company number one,” says the chief executive of another oil company.

Rigid production targets used to be fashionable. Now most oil companies have given them up and focus on returns to shareholders instead. Lord Browne liked to think that BP was different. A better mix of assets, and a better strategy, meant that the company's reserves could rise without splurging cash. He still insists that the company will manage its promised average 5.5% yearly production increase in the medium term, to 2005. But this will cost around $1 billion in extra investment.

The market is not terribly impressed by that. Nor did it much like the profit figures for the first nine months of the year, which showed a 38% drop in net income. BP's shares hit a four-year low this week, and Lord Browne's highly polished reputation has some greasy smears. The “Browne premium” which put BP's valuation ahead of its European peers has eroded sharply.

There are other problems too. Some of the top management around him looks a bit stale. A row over safety in Alaska made the company look careless and mean. Some wonder if Lord Browne's icy, driven style forced managers to cut corners and sit on bad news until it was too late.

None of this is life-threatening. Lord Browne's reputation may be a bit overblown, but he is still one of the few British bosses with real kudos in world business. He has bounced back before—for example after his company's first, disastrous adventure into Russia. Analysts think that he may find a sense of crisis quite useful in dispelling any complacency caused by a long period of high oil prices. A management shake-out early next year, and a new round of cost-cutting, would do a lot to restore confidence. So would an outright admission that it is not pumping lots of oil out of the ground, but selling it at a profit—the best way of pleasing shareholders.

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Celebrity sex

Lie back and enjoy it

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From The Economist print edition

Britain's scandal-prone celebrities are weeping all the way to the bank

SCANDAL-PRONE, or just prone and scandalous? It is proving to be a spicy autumn in the fame-crazed world of popular culture. It may be no particular surprise to read of a popular quiz show host, Angus Deayton, accused of taking drugs and multiple infidelity; nor to see newspaper photographs of a breakfast television presenter, John Leslie, snorting his regulation line of cocaine; nor to read the autobiography of Ulrika Jonsson, another television presenter, whose affair with Sven Goran Eriksson, the manager of the England football team whose girlfriend Nancy...oh, that's enough.

What is odd is the seriousness with which the politicians and the BBC take these matters. The BBC sacked Mr Deayton, even though each new exposé drove up his programme's viewing figures. The secretary of state for culture, Tessa Jowell, calls television celebrities “role models”, who should remember their responsibilities.

This puritanism is a sad comment on the state of Britain's public life. All these stories have brought joy to the nation's breakfast-tables and cheer to the offices of newspaper executives, for it is strange, but true, that penetrating analyses of the public-sector finances do not do as much for a newspaper's circulation as stories of Z-list celebrity penetration.

Nor does much of what passes for celebrity scandal have any bearing on real life. Many allegations (especially of infidelity) are cooked up by celebrities' image-makers, who worry that their client is not getting enough headlines. Pap television programmes (ie, most of them) and celebrity magazines need a diet of sensationalist trash to titillate their viewers and listeners. It is hard to argue that the bedroom antics of a television presenter are any more damaging to the nation's morals than the incestuous, violent (but fictional) lives of the soap opera characters with whom they share the screen. Not to mention the things that politicians get up to.

Does anyone really suffer from this? Parents may have some trouble explaining to their children what the nice man from the telly is doing in the picture with the £20 note. Public figures with blameless private lives may find the media's habitual prurience so unbearable that they leave office. This seems to have been a factor in last week's resignation by Estelle Morris, the secretary for education. But it is hard to feel sorry for Mr Deayton and his like. He may have lost his job, but there is only a ghost-writer's keyboard between him and a lucrative celebrity autobiography.

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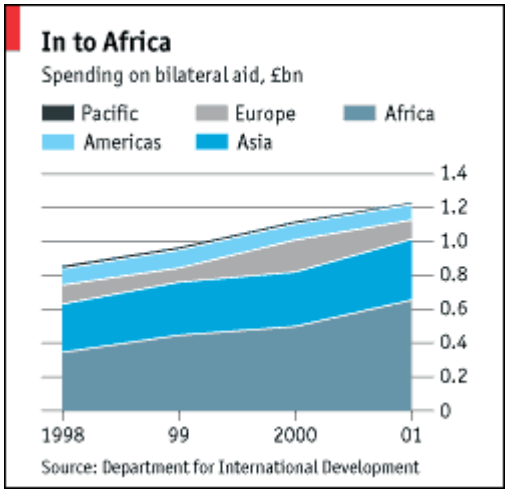
Aid policy

Short change

Oct 31st 2002 | JOHANNESBURG
From The Economist print edition

Britain hopes good governments will help rebuild African states. Dream on



NEVER mind the projects, look at the governments. That, roughly, is Britain's evolving aid policy for Africa. First set out in a white paper on aid two years ago, the Department for International Development (DFID) is now applying its plan to cut poverty and boost feeble public administration. Britain is giving more money directly to African treasuries, but only in favoured (often Anglophone) countries where Ms Short is friendly with the president. In turn, the chosen few promise to stop wars, cut corruption and spend more on the poor. A few weeks ago, Ms Short was schmoozing in London with two of her closest chums, Rwanda's Paul Kagame and Uganda's Yoweri Museveni.

Most donors have been getting meaner recently. Total aid from the 22 richest countries fell from $56 billion in 1999 to $53 billion in 2000, says Action Aid, a charity. But Britain is gradually spending more. When Labour took office in 1997, aid was just 0.26% of national income. By 2005-06 it is supposed to be 0.4%, or £4.6 billion ($7.1 billion). Africa will gain especially. Tony Blair promised this year that annual aid to Africa would top £1 billion; sub-Saharan Africa already gets 43% of non-humanitarian bilateral aid, and three of the top five recipient countries of British aid are African former colonies (Uganda, Tanzania and Ghana). Even more British help goes to Africa through multilateral efforts.

It is not just new cash, but cash spent in new ways. In the past, Britain's aid policy stressed projects, such as schools and hospitals, and used non-governmental organisations (NGOs) as partners. Ms Short dislikes many NGOs as unelected and economically illiterate whingers.There are practical problems too. Finding enough good projects to absorb the growing budget is impossible. In 1996-97, £4.5m of DFID's Africa budget was unallocated. In 2000-01, that rose to £18m.

Worse, simply paying for projects may do more harm than good. Like foreign-funded NGOs, projects often pay better wages than African civil services, and so suck the best qualified people out of state service. Donors pay for buildings (schools, say) but forget the costs of keeping them going (such as teachers' salaries). The projects may be ill-chosen, or overlapping. By one recent estimate there were 140 different donor-funded agricultural schemes in Kenya; in Tanzania there have been hundreds of schooling projects with no common curriculum or goals.

So Ms Short wants a new kind of aid: not charity, but “part of the process of building modern, effective states.” Official funds will bypass NGOs except for short-term emergency projects such as coping with southern Africa's current food shortage. Instead, more aid will go into government budgets.

In Maputo, DFID has opened shiny new offices overlooking the Indian Ocean. Though there are desks for 25 people, much of the rapidly expanding budget of £35m is supposed to go straight to government coffers. A quarter of the government's budget now comes from donors; in Uganda it is nearer half. In September Ms Short said there would be similar long-term deals with Tanzania (£135m budget support over the next three years), Rwanda, Ghana, Sierra Leone and Uganda. Such help coincides with debt relief and countries' own poverty-reduction programmes that are financed (and, in fact, mostly written) by the International Monetary Fund and World Bank. Other European donors are following suit.

The dangers are obvious. “A very high proportion of aid budgets is now going to an instrument that is not

yet proven," says one DFID worker in Africa. "You're putting your money into a very leaky bucket," warns another. Developing trust and partnership with kleptocrats is hard. In Mozambique the state recently refinanced various banks that had been looted, probably by cronies of the ruling party. Other governments hanker after grand projects that do nothing to help the poor. Tanzania plans to buy an unnecessary £28m military air-traffic-control system, and in July Ms Short defended its president, Benjamin Mkapa, for spending £15m on a presidential jet.

Other recipients are too keen to fight wars. Uganda appears to be slashing ministries' budgets to release more cash to fight rebels on the border with Sudan. Until this month, Rwanda's army was one of the main protagonists in Congo's war.

Britain does try to monitor how its cash is spent: for example, the two dozen DFID workers in Maputo will assess how much money in Mozambique goes on health, education and anti-poverty work. But foreign cash for health may release other resources for the army. And too much foreign monitoring easily sparks local complaints of "neo-colonialist" donors. Ms Short is right that African states desperately need better government, but British taxpayers also deserve to know exactly where their money ends up.

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NHS

Blood-letting

Oct 31st 2002
From The Economist print edition

Consultants have delivered a blow to the government's plan to modernise the National Health Service

Get article background

IT TOOK the government and the British Medical Association two years to negotiate a new contract for hospital consultants—the first major reform of their contract since the NHS was founded in 1948. It took consultants in England and Wales little more than four months to reject it. The result of the top doctors' ballot, announced on October 31st, was a resounding two-to-one majority against the new contract.

Consultants have long dominated the NHS. They agreed to the setting up of the health service only in return for the concession that they should be allowed to go on practising privately while being paid by the state. Over the past two decades some of their freedom has been eroded as governments have sought to take managerial control over the NHS. That process has accelerated with Labour's drive to improve health care through centrally-set targets and monitoring. But as their ballot has demonstrated, the consultants are unwilling to cede any more of their power to hospital managers.

Their vote was a snub not just to the government but to the British Medical Association. The BMA had endorsed the new contract, not least since it secured pay increases of up to 20%. The contract also retained the right of new consultants to work in private practice, which the government had threatened to remove for their first seven years. In return, consultants had to accept greater control by NHS managers, including more flexible work schedules, such as evening and weekend sessions.

However, many consultants saw matters very differently. Some were unhappy about agreeing to work in the evenings and at weekends at normal rates of pay. Others argued that existing consultants would gain less than new ones. But, according to the BMA, the issue that united those opposing the new contract was fear of strengthening managerial control. Consultants bridled at the prospect of surrendering more of their cherished clinical freedoms to hospital managers, driven by performance targets set in Whitehall.

Consultants in Scotland and Northern Ireland backed the deal—probably because staffing levels are higher, so they feel under less pressure—so the new contract can be introduced there. After the consultants in England and Wales voted to reject the deal, the government announced there would be no re-negotiation. It will probably leave the new contract on the table. That would allow hospital managers to use it as the basis for local negotiations with consultants.

On the face of it, this is a serious setback for the government. Ministers know that recruiting more doctors is not enough: their time also has to be used more effectively. In evidence to Parliament about the advantages of the new contract to the NHS, Alan Milburn, the health minister, said that “the biggest gain of all is better management grip on how NHS consultants spend their time,” and that the new contracts would mean that consultants with private practice would spend 14% more time working for the NHS.

However, the extension of detailed managerial control can be “a double-edged sword” warns Kieran Walshe, research director at Manchester University's Centre for Healthcare Management: consultants can work to the letter rather than the spirit of the contract. In a similar vein, Anthony Harrison of the King's Fund, a health-policy think-tank, says that mutual trust between managers and consultants is essential if the NHS is to modernise and improve patient care in hospitals. “It isn't just a question of hours, it's a question of how you do your work and how you co-operate with other professionals.”

No contract will deliver better performance if it is made with an alienated workforce. That is the real

problem that the consultants' ballot has highlighted. Nick Bosanquet, professor of health policy at Imperial College, London, says that the vote is “a sign of the considerable strain that the NHS is under: the basic issue is how to make use of this very scarce resource of consultants' time.”

The consultants' ballot is a setback for the government's plan to modernise the NHS. But it points to a better alternative: for contracts to be negotiated at local rather than national level. Local bargaining would fit better than a national contract with Tony Blair's idea of giving a freer hand to the best NHS hospitals; and it might make the doctors less cross, too.

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Tories

Is it time to go?

Oct 31st 2002
From The Economist print edition

Panic and despair are fuelling rumours of a challenge to Iain Duncan Smith

WITH Tory morale sinking steadily after months of dismal poll results, it was inevitable that the question of replacing the party's leader, Iain Duncan Smith, would surface at Westminster. The self-proclaimed “quiet man” of British politics has made so little impact that a MORI poll has just recorded the biggest “don't know” verdict that an opposition leader has ever secured at this point in their career. Even a majority of Conservative supporters are unhappy with his performance while his rating among the public at large has sunk to its lowest point since he was elected leader one year ago.

A spate of stories in normally loyal Tory newspapers this week suggest that, if the party's fortunes do not soon improve, a challenge to the Conservative leader can not be ruled out next year. Despair at the prospect of another huge election defeat has begun to infect not just the jittery ranks of Tory MPs and their constituency parties but also Central Office. A former senior cabinet minister in Margaret Thatcher's government said the issue now was not whether the party could win the next election but how badly it might lose. If Labour secured a majority of more than 100, as he believed it would, then the Tories would probably be out of power for a generation. Another senior backbencher said bitterly: “I think it is terribly sad. Unless this party grows up, it is unelectable.”

Doubts about Mr Duncan Smith's leadership have been fuelled by poor parliamentary performances, particularly at the weekly joust of prime minister's questions. One Tory commentator wrote that the spectacle of Tony Blair demolishing the opposition leader was too “painful and pitiful” to watch. Tory MPs were in such a febrile state at this week's question time that it almost seemed as though a general election was imminent.

If despair is rife, panic is not far off. Should the Tories perform poorly at next year's local elections, then serious plotting is bound to begin. Mr Duncan Smith's critics are already reported to be taking soundings about whether they could secure the necessary 25 names—15% of the parliamentary party—required for a formal leadership challenge. That hurdle, erected by the former leader, William Hague, will not be easy to surmount. Most Tory MPs, whatever their private views, will be reluctant to plunge the party into its seventh leadership election in 15 years. Mr Duncan Smith is also the first Conservative leader to be elected by the whole party. To throw him out after just a year would not look like the action of a serious party.

A further problem is that none of the potential leadership rivals looks eager for battle. Both Michael Portillo and Kenneth Clarke, who were beaten in the last leadership contest, have made it clear that they would be reluctant to stand again unless they were assured of victory—which, in the fractious, bitterly-divided Tory party, is hardly likely. The only other serious challenger, David Davis, whose sacking as party chairman this summer sparked off many of the present discontents, is seen as a plotter and even more divisive.

On this view, Mr Duncan Smith is not likely to be ousted imminently, if only because nobody else wants to lead the party right now. As a Tory backbencher says, “Iain is going to survive because no one will have the courage or the determination to take him on.”

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Scottish politics

Macs, money and muck

Oct 31st 2002 | EDINBURGH
From The Economist print edition

Grubbiness in Scottish politics

Get article background

WHAT is it with Scottish politicians and money? A year after Henry McLeish was forced to resign as first minister following a scandal about his office expenses, Jack McConnell, his successor, seems to be deep in a similar mire. Surely Scotland, having lost two first ministers in the first three years of devolution, is not about to lose another?

Newspapers claim that anything between £11,000 and £50,000 seem to be missing from the accounts of Mr McConnell's local Labour Party. Questions are being asked about accounts for local party fund-raising dinners which appear, for reasons not yet explained, to have been used as a conduit for trade union donations destined for election funds. Media interest in the dinner accounts is high because one was attended by a drugs dealer who was shot dead, presumably by gangster rivals, a few days later.

Such dramatic events aside, not much wrongdoing has yet been proved. Labour Party officials have admitted that Mr McConnell's local party failed to declare a £1,500 trade union donation to the electoral commission, the political spending watchdog. A trawl of other Scottish local party accounts found that half a dozen others had also broken similar transparency rules.

The root of the money problem appears to be that a local party official took a five-figure sum from an account. When this was discovered by local party auditors, it was agreed that the cash should be repaid and the police kept out of things. But then the affair hit the headlines. Scottish Labour officials sent in independent accountants to check the books which are, they admit, a complete mess. Lesley Quinn, the Scottish party secretary, says she will publish the report and, if need be, report any apparent crimes to the police.

Mr McConnell says that he cannot be expected to supervise local party accounts. While there are questions yet to be answered about expenses claimed when he stood for the Scottish Parliament in 1999 and when he unsuccessfully contested the Scottish party leadership in 2000, he says he will await the accountants' verdict. In any case, his aides say, the £50,000 figure is nonsense and, unlike the McLeish scandal which involved taxpayers' money, only Labour Party money is at stake here.

So why won't the political hue and cry go away? One reason is that Mr McConnell's Motherwell and Wishaw constituency is in Lanarkshire where none but Labour have held power for decades. One-party states breed corruption; what's more, party rivals who have come off worst in previous clashes with Mr McConnell seem bent on using this affair to undermine the first minister. So Machiavellian are Lanarkshire politics that some even theorise that Mr McConnell's apparent allies may be conspiring to oust him. And few journalists thought that the McLeish affair, when it first surfaced, amounted to much, so they dare not let this one go in case the same thing happens again, especially as Mr McConnell has a record of sailing close to the wind.

The best thing to be said for all this is that it is coming to light. Such are the transparency rules and the media scrutiny that surrounds the Scottish Parliament that no politician can afford the tiniest transgression. In that sense, devolution is cleaning up Scottish politics. But what a mess is being made on the way.

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Bagehot

Who's handbagging whom?

Oct 31st 2002
From The Economist print edition

It's not Tony Blair who finds himself angry and isolated in Europe these days

THE collective sigh of relief was almost audible. As Tony Blair reported to the House of Commons this week on his very public bust-up with the French president, one thing was clear: relations with France were back to normal. Jacques Chirac had accused Mr Blair of speaking to him in a way that he had never been spoken to before. So rude had Mr Blair been that Mr Chirac also cancelled an imminent Anglo-French summit (since resentfully reinstated to take place in January).

No longer would we have to take seriously the awful notion, once encouraged by the Downing Street spin machine, that Jacques and Tony were best buddies who liked nothing more than to sort out Europe's problems over a convivial dinner. After Mr Chirac's ruthless coup to stymie agricultural reform, what price the prime minister's hopeful words of only a few weeks ago? “The way to get the right answers,” said Mr Blair, “is by being in there, vigorous, confident, leading in Europe, not limping along several paces behind.” And what joy that even such a hopeless Europhile as Mr Blair now finds himself in the same position as all his recent predecessors: fighting a lonely, and usually losing, battle against the old enemy across the Channel.

Sadly for much of the British press, who would like nothing better than for the prime minister to seize the same fraying standard that the Iron Lady used to carry into her mostly doomed Eurobattles, as the European Research Institute's Anand Menon noted in the *Financial Times*, it is Mr Chirac, ironically, who more resembles Margaret Thatcher than Mr Blair. It is Mr Chirac who, when he surveys the direction in which Europe is going, wants to stop the train. Mr Chirac is frightened by the accession of the ten new members from Central Europe, Malta and Cyprus and the consequent pressures for budgetary reform and economic liberalisation—all developments that Mr Blair positively welcomes.

Which is why the claims of British isolation and humiliation in Brussels are much overdone. What actually happened was this: on October 24th, Mr Chirac succeeded in browbeating the German chancellor, Gerhard Schröder, into shelving any real reform of the common agricultural policy until 2006 and allowing spending to increase by 1% a year until 2013. In exchange, Mr Schröder secured Mr Chirac's acquiescence that enlargement would take place on time in 2004, a major aim of both German and British policy. German officials, including the foreign minister, Joschka Fischer, quickly realised that Mr Schröder, well-known to be a poor negotiator, had conceded too much. Despite furious rows between the Germans and the French the next morning, Mr Chirac held on tight to his spending increase.

But in the afternoon, the Germans, stiffened by the British and supported by the Dutch, the Italians, the Swedes, the Danes and even the Belgians, confirmed that there was no deal to halt the mid-term review of the CAP being carried out by the EU's agricultural commissioner, Franz Fischler, which is likely to shift spending from production subsidies to broader rural development goals. To Mr Chirac's fury, Mr Blair led the way in attacking the damage already done, saying that it made rational decision-making in the Council of Ministers impossible.

But what really touched a nerve was Mr Blair asking whether declaring concern for Africa's poverty while preserving the CAP as a barrier to its agricultural exports was not likely to strike the world outside as rank hypocrisy. What, Mr Blair wanted to know, could the EU now offer the Doha round of world trade talks due to end in 2005? In other words, Mr Chirac's antics were not so much an affront to British interests, as unpardonable insouciance about the pernicious impact of an unreformed CAP on a much wider international agenda. It is a point that few of Europe's leaders would dare publicly to disagree with and thus much more devastating than being on the receiving end of an occasional swipe from the Thatcherite handbag.

Going with the tide

In an equally unThatcherite way too, Mr Blair is calm about the project to create a new constitution for Europe. The “skeleton” draft published this week by the chairman of the convention, a previous French president, Valéry Giscard d'Estaing, is full of federalist waffle—the suggestion, among others, that there might be some kind of parallel European citizenship is enough to make the flesh of any self-respecting Eurosceptic creep. But these are dismissed as “Giscard's discards”, little “jeux d'esprit” not intended to be taken too seriously. On the important things, mostly those to do with the power and prerogatives of the big countries, the British are quietly pleased with the start that's been made. For the most part, the French have similar interests, but are making much less impression on the process, mainly because they won't be seen to be working with the British. In exasperation, the EU's French trade commissioner, Pascal Lamy, observed that as a result “the British are leading the dance.”

For the moment, the question of Britain's euro entry is parked—Mr Blair's intentions are not doubted and the timing is seen as a matter for him. But Iraq is another matter. While there is some sympathy for the idea that Mr Blair has been a restraining influence on the Americans, his closeness to Mr Bush and apparent keenness to go to war is disturbing to many Europeans in a way that Mr Schröder's quasi-pacifism and even Mr Chirac's Gaullist posturing are not. But that is also quite likely to change, whatever happens over Iraq in the short term. Most of the accession countries, as befits recent escapees from the Soviet empire, are passionately pro-American and opposed to anything that might weaken the transatlantic security relationship.

Like Mrs Thatcher, Mr Chirac knows how to play a weak hand with aplomb. But the best that the French president can hope for is to delay the inevitable. While Mr Chirac rages against the tide of history, Mr Blair sees it as his ally.

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The longest journey

Oct 31st 2002
From The Economist print edition

REX

Freeing migration could enrich humanity even more than freeing trade. But only if the social and political costs are contained, says Frances Cairncross

Get article background

“WITH two friends I started a journey to Greece, the most horrendous of all journeys. It had all the details of a nightmare: barefoot walking in rough roads, risking death in the dark, police dogs hunting us, drinking water from the rain pools in the road and a rude awakening at gunpoint from the police under a bridge. My parents were terrified and decided that it would be better to pay someone to hide me in the back of a car.”

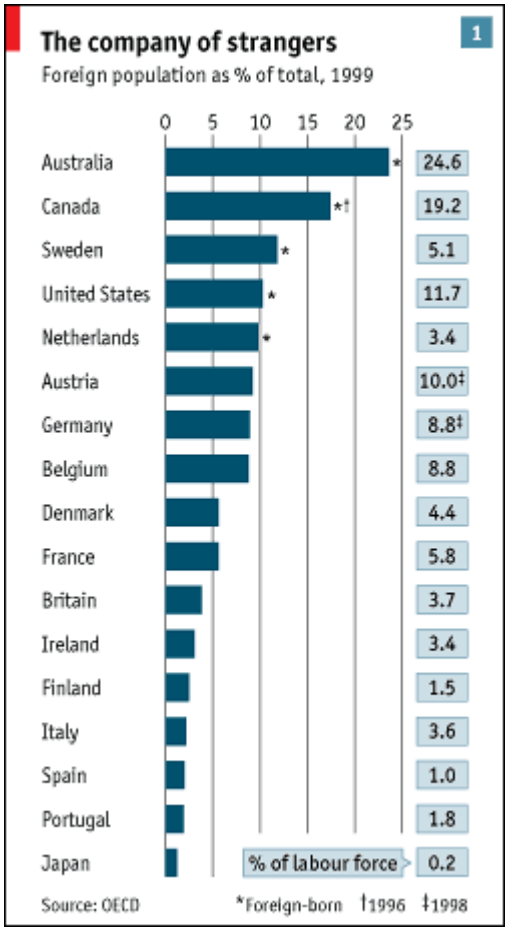
This 16-year-old Albanian high-school drop-out, desperate to leave his impoverished country for the nirvana of clearing tables in an Athens restaurant, might equally well have been a Mexican heading for Texas or an Algerian youngster sneaking into France. He had the misfortune to be born on the wrong side of a line that now divides the world: the line between those whose passports allow them to move and settle reasonably freely across the richer world's borders, and those who can do so only hidden in the back of a truck, and with forged papers.

Tearing down that divide would be one of the fastest ways to boost global economic growth. The gap between labour's rewards in the poor world and the rich, even for something as menial as clearing tables, dwarfs the gap between the prices of traded goods from different parts of the world. The potential gains from liberalising migration therefore dwarf those from removing barriers to world trade. But those gains can be made only at great political cost. Countries rarely welcome strangers into their midst.

Everywhere, international migration has shot up the list of political concerns. The horror of September 11th has toughened America's approach to immigrants, especially students from Muslim countries, and blocked the agreement being negotiated with Mexico. In Europe, the far right has flourished in elections in Austria, Denmark and the Netherlands. In Australia, the plight of the *Tampa* and its human cargo made asylum a top issue last year.

Although many more immigrants arrive legally than hidden in trucks or boats, voters fret that governments have lost control of who enters their country. The result has been a string of measures to try to tighten and enforce immigration rules. But however much

governments clamp down, both immigration and immigrants are here to stay. Powerful economic forces are at work. It is impossible to separate the globalisation of trade and capital from the global movement of people. Borders will leak; companies will want to be able to move staff; and liberal democracies will balk at introducing the draconian measures required to make controls truly watertight. If the European Union admits ten new members, it will eventually need to accept not just their goods but their workers too.



Technology also aids migration. The fall in transport costs has made it cheaper to risk a trip, and cheap international telephone calls allow Bulgarians in Spain to tip off their cousins back home that there are fruit-picking jobs available. The United States shares a long border with a developing country; Europe is a bus-ride from the former Soviet block and a boat-ride across the Mediterranean from the world's poorest continent. The rich economies create millions of jobs that the underemployed young in the poor world willingly fill. So demand and supply will constantly conspire to undermine even the most determined restrictions on immigration.

For would-be immigrants, the prize is huge. It may include a life free of danger and an escape from ubiquitous corruption, or the hope of a chance for their children. But mainly it comes in the form of an immense boost to earnings potential. James Smith of Rand, a Californian think-tank, is undertaking a longitudinal survey of recent immigrants to America. Those who get the famous green card, allowing them to work and stay indefinitely, are being asked what they earned before and after. “They gain on average $20,000 a year, or $300,000 over a lifetime in net-present-value terms,” he reports. “Not many things you do in your life have such an effect.”

Such a prize explains not only why the potential gains from liberalising immigration are so great. It explains, too, why so many people try so hard to come—and why immigration is so difficult to control. The rewards to the successful immigrant are often so large, and the penalties for failure so devastating, that they create a huge temptation to take risks, to bend the rules and to lie. That, inevitably, adds to the hostility felt by many rich-world voters.

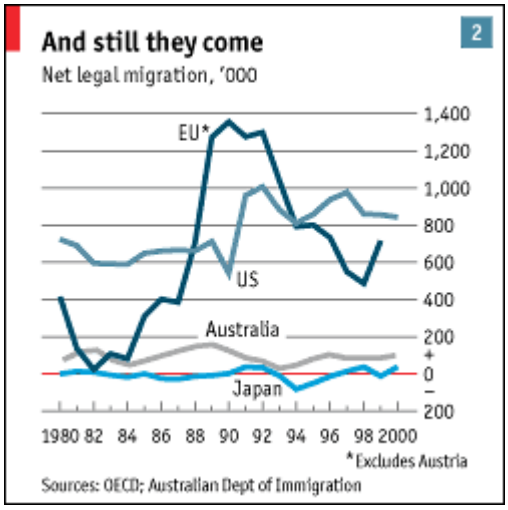
This hostility is milder in the four countries—the United States, Canada, Australia and New Zealand—that are built on immigration. On the whole, their people accept that a well-managed flow of eager newcomers adds to economic strength and cultural interest. When your ancestors arrived penniless to better themselves, it is hard to object when others want to follow. In Europe and Japan, immigration is new, or feels new, and societies are older and less receptive to change.

Even so, a growing number of European governments now accept that there is an economic case for immigration. This striking change is apparent even in Germany, which has recently been receiving more foreigners, relative to the size of its population, than has America. Last year, a commission headed by a leading politician, Rita Süssmuth, began its report with the revolutionary words: “Germany needs immigrants.” Recent legislation based on the report (and hotly attacked by the opposition) streamlines entry procedures.

But there is a gulf between merely accepting the economic case and delighting in the social transformation that immigrants create. Immigrants bring new customs, new foods, new ideas, new ways of doing things. Does that make towns more interesting or more threatening? They enhance baseball and football teams, give a new twang to popular music and open new businesses. Some immigrants transform drifting institutions, as Mexicans have done with American Catholicism, according to Gregory Rodriguez, a Latino journalist in Los Angeles. And some commit disproportionate numbers of crimes.

They also profoundly test a country's sense of itself, forcing people to define what they value. That is especially true in Europe, where

many incomers are Muslims. America's 1.2m-1.5m or so Muslim immigrants tend to be better educated and wealthier than Americans in general. Many are Iranians, who fled extremist Islam. By contrast, some of the children of Germany's Turks, Britain's Pakistanis and France's North Africans seem more attracted to fundamentalism than their parents are. If Muslims take their austere religion seriously, is that deplorable or admirable? If Islam constrains women and attacks homosexuality, what are the boundaries to freedom of speech and religion? Even societies that feel at ease with change will find such questions hard.



No but, maybe yes

Immigration poses two main challenges for the rich world's governments. One is how to manage the inflow of migrants; the other, how to integrate those who are already there.

Whom, for example, to allow in? Already, many governments have realised that the market for top talent is global and competitive. Led by Canada and Australia, they are redesigning migration policies not just to admit, but actively to attract highly skilled immigrants. Germany, for instance, tentatively introduced a green card of its own two years ago for information-technology staff—only to find that a mere 12,000 of the available 20,000 visas were taken up. “Given the higher wages and warmer welcome, no Indians in their right minds would rather go to Germany than to the United States,” scoffs Susan Martin, an immigration expert at Georgetown University in Washington, DC.

Whereas the case for attracting the highly skilled is fast becoming conventional wisdom, a thornier issue is what to do about the unskilled. Because the difference in earnings is greatest in this sector, migration of the unskilled delivers the largest global economic gains. Moreover, wealthy, well-educated, ageing economies create lots of jobs for which their own workers have little appetite.

So immigrants tend to cluster at the upper and lower ends of the skill spectrum. Immigrants either have university degrees or no high-school education. Mr Smith's survey makes the point: among immigrants to America, the proportion with a postgraduate education, at 21%, is almost three times as high as in the native population; equally, the proportion with less than nine years of schooling, at 20%, is more than three times as high as that of the native-born (and probably higher still among illegal Mexican immigrants).

All this means that some immigrants do far better than others. The unskilled are the problem. Research by George Borjas, a Harvard University professor whose parents were unskilled Cuban immigrants, has drawn attention to the fact that the unskilled account for a growing proportion of America's foreign-born. (The same is probably true of Europe's.) Newcomers without high-school education not only drag down the wages of the poorest Americans (some of whom are themselves recent immigrants); their children are also disproportionately likely to fail at school.

These youngsters are there to stay. “The toothpaste is out of the tube,” says Mark Krikorian, executive director of the Centre for Immigration Studies, a think-tank in Washington, DC. And their numbers will grow. Because the rich world's women spurn motherhood, immigrants give birth to many of the rich world's babies. Foreign mothers account for one birth in five in Switzerland and one in eight in Germany and Britain. If these children grow up underprivileged and undereducated, they will create a new underclass that may take many years to emerge from poverty.

For Europe, immigration creates particular problems. Europe needs it even more than the United States because the continent is ageing faster than any other region. Immigration is not a permanent cure (immigrants grow old too), but it will buy time. And migration can “grease the wheels” of Europe's sclerotic labour markets, argues Tito Boeri in a report for the Fondazione Rodolfo Debenedetti, published in July. However, thanks to the generosity of Europe's welfare states, migration is also a sort of tax on immobile labour. And the more immobile Europeans are—the older, the less educated—the more xenophobic they are too.

The barriers need to be dismantled with honesty and care. It is no accident that they began to go up when universal suffrage was introduced. Poor voters know that immigration threatens their living standards. And as long as voters believe that immigration is out of control, they will oppose it. Governments must persuade them that it is being managed in their interests. This survey will suggest some ways in which that might be done.

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Irresistible attraction

Oct 31st 2002
From The Economist print edition

Who moves, and why

LEAVING one's home to settle in a foreign land requires courage or desperation. No wonder only a tiny fraction of humanity does so. Most migration takes place within countries, not between them, part of the great procession of people from country to town and from agriculture to industry. International migrants, defined as people who have lived outside their homeland for a year or more, account for under 3% of the world's population: a total, in 2000, of maybe 150m people, or rather less than the population of Brazil. Many more people—a much faster-growing group—move temporarily: to study, as tourists, or to work abroad under some special scheme for a while. However, the 1990s saw rapid growth in immigration almost everywhere, and because population growth is slowing sharply in many countries, immigrants and their children account for a rising share of it.

PA

Innumerable

Counting migrants is horrendously difficult, even when they are legal. Definitions vary. Some countries keep population registers, others do not. The visitor who comes for a holiday may stay (legally or illegally) to work. Counting those who come is hard, and only Australia and New Zealand rigorously try to count those who leave. So nobody knows whether the rejected asylum-seeker or the illegal who has been told to leave has gone or stayed. But the overall picture is one of continuing growth in the late 1990s.

Between 1989 and 1998, gross flows of immigrants into America and into Europe (from outside the EU) were similar, relative to population size. About 1m people a year enter America legally, and some 500,000 illegally; about 1.2m a year enter the EU legally, and perhaps 500,000 illegally. In both America and Europe, immigration has become the main driver of population growth. In some places, the effects are dramatic. Some 36% of New York's present population is foreign-born, says Andrew Beveridge, a sociology professor at Queens College, New York: “It hasn't been that high since 1910,” the last peak.

America at least thinks of itself as an immigrant land. But for many European countries the surge of arrivals in the 1990s came as a shock. For example, the Greek census of 2001 found that, of the 1m rise in the population in the previous decade (to 11m), only 40,000 was due to natural increase. “In a decade, Greece has jumped from being one of the world's least immigrant-dense countries to being nearly as immigrant-dense as the United States,” notes Demetrios Papademetriou, co-director of the newly created Migration Policy Institute in Washington, DC.

Asia too saw a burst of immigration in the 1990s, propelled initially by the region's economic boom. Foreign workers accounted for an increasing share of the growth in the labour supply in the decade to the mid-1990s. Chris Manning, an economist at the Australian National University in Canberra, reckons that

foreign workers made up more than half the growth in the less-skilled labour force in Malaysia, perhaps one-third of the growth in Thailand and 15-20% of the growth in Japan, South Korea and Taiwan.

What makes all these people move? In the past, governments often imported them. In Europe, migration in the 1950s and 1960s was by invitation: Britain's West Indians and Asians, for example, first came at the government's request. Britain's worst racial problems descend from the planned import of textile and industrial workers to northern England. Now the market lures the incomers, which may produce less disastrous results.

The going rate 3

Payments to traffickers for selected migration routes
$ per person

Kurdistan-Germany	3,000
China-Europe	10,000-15,000
China-New York	35,000
Pakistan/India-US	25,000
Arab states-UAE	2,000-3,000
North Africa-Spain	2,000-3,500
Iraq-Europe	4,100-5,000
Middle East-US	1,000-15,000
Mexico-Los Angeles	200-400
Philippines-Malaysia/Indonesia	3,500

Source: "Migrant Trafficking and Human Smuggling in Europe", International Organisation for Migration, 2000

Three forces often combine to drive people abroad. The most powerful is the hope of economic gain. Alone, though, that may not be enough: a failing state, as in Somalia, Sri Lanka, Iraq or Afghanistan, also creates a powerful incentive to leave. Lastly, a network of friends and relatives lowers the barriers to migrating. Britain has many Bangladeshi immigrants, but most come from the single rural district of Sylhet. Many host countries "specialise" in importing people from particular areas: in Portugal, Brazilians account for 11% of foreigners settling there; in France, Moroccans and Algerians together make up 30% of incomers; and in Canada, the Chinese share of immigrants is more than 15%.

Most very poor countries send few people abroad. Immigration seems to start in earnest with the onset of industrialisation. It costs money to travel, and factory jobs provide it. That pattern emerges strikingly from a study by Frank Pieke of Oxford University of emigration from China's Fujian province. He describes how internal and overseas migration are intertwined. Typically, a woman from a family will go to work in a factory in a nearby province, supporting a man who then goes abroad and probably needs a few months to find himself a job.

Incentives to go, incentives to stay

Net immigration flows continue as long as there is a wide gap in income per head between sending and receiving countries. Calculations by the OECD for 1997 looked at GDP per head, adjusted for purchasing power, in the countries that sent immigrants to its rich members, and compared that figure with GDP per head in the host country. In all but one of its seven largest members, average annual income per person in the sending countries was less than half that of the host country.

Migrant flows peter out as incomes in sending and host country converge. Philip Martin, an economist from the University of California at Davis, talks of a "migration hump": emigration first rises in line with GDP per head and then begins to fall. Migration patterns in southern Europe in the 1980s suggested that the turning point at that time came at just under $4,000 a head. In a study for the European Commission last year of the prospective labour-market effect of EU enlargement, Herbert Brücker, of Berlin's German Institute for Economic Research (DIW), estimated that initially 335,000 people from the new members might move west each year, but that after ten years the flow would drop below 150,000 as incomes converged and the most footloose had gone. Net labour migration usually ends long before wages equalise in sending and host countries.

Migrants do not necessarily come to stay. They may want to work or study for a few months or years and then go home. But perversely, they are more likely to remain if they think that it will be hard to get back once they have left. "If you are very strict, you have more illegals," observes Germany's Ms Süssmuth.

There has always been a return flow of migrants, even when going home meant a perilous return crossing of the Atlantic. According to Dan Griswold of the Cato Institute, a right-of-centre American think-tank, even in the first decade of the 20th century 25-30% of migrants eventually went home. And where migrants are free to come and go, many do not come in the first place. There is no significant net migration between the United States and Puerto Rico, despite free movement of labour. "It's expensive to be underemployed in America," explains Mr Griswold. But in Europe, with its safety net of welfare benefits, the incentives to have a go are greater.

Tougher border controls deter immigrants from returning home. A book co-authored by Douglas Massey of the University of Pennsylvania, "Beyond Smoke and Mirrors", describes how in the early 1960s the end

of a programme to allow Mexicans to work temporarily in America led to a sharp rise in illegal immigrants. Another recent study, published in *Population and Development Review*, also links tighter enforcement to a switch from temporary to permanent migration. Its author, Wayne Cornelius, says the fees paid to *coyotes*, people who smuggle migrants, have risen sharply. He found that, when the median cost of a *coyote*'s services was $237, 50% of male Mexican migrants went home after two years in the United States; but when it had risen to $711, only 38% went back. And, whereas the cost of getting in has risen(as have the numbers who die in the attempt), the cost of staying put has declined, because workplace inspections to catch illegals have almost ceased. The chance of being caught once in the country is a mere 1-2% a year, Mr Cornelius reckons. So “The current strategy of border enforcement is keeping more unauthorised migrants *in* the US than it is keeping *out*.”

Tighter controls in Europe are probably creating similar incentives to stay rather than to commute or return. A complex, bureaucratic system designed to keep many willing workers away from eager employers is bound to breed corruption and distortion. And the way that rich countries select immigrants makes matters worse.

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The best of reasons

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Who gets in

ONE of the many oddities of migration policy is that immigrants coming in to work permanently are usually a minority of those who arrive legally. Most host countries admit migrants mainly on grounds that have nothing to do with work. They also admit two large groups on grounds that have nothing to do with their skills or education, even though these characteristics may determine how rapidly they integrate.

Almost everywhere, the biggest group consists of relatives of those who have already arrived. In the United States they account for three-quarters of all legal permanent migrants. America even gives a few visas to migrants' adult siblings. In parts of Europe, family reunification has become family formation, and sometimes delays integration: for instance, it allows third-generation Pakistanis to seek spouses from among their cousins back in rural Mirpur. The policy also reinforces the characteristics of earlier arrivals. Unskilled migrants are likely to have less educated relatives than are skilled migrants.

Panos

Where can we send them now?

In Europe, and especially northern Europe, the other main route of legal entry is to claim asylum. The number of claims has fallen by half since the early 1990s, partly because peace has returned to former Yugoslavia, and partly because of tougher rules, but still seems to be higher than in the United States. America cut the numbers sharply after the first attack on the World Trade Centre in 1993, mainly by refusing to allow asylum-seekers to work or draw any welfare benefits for the first six months of their stay, and by speeding the claims process. Many European countries are now moving that way.

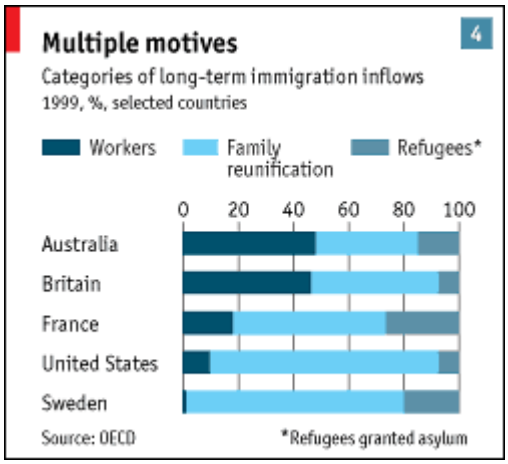
Both marriage and asylum-seeking are clearly open to abuse by the desperate or the unscrupulous. Many asylum-seekers are fleeing poverty and disorder rather than persecution. It is usually impossible to establish whether or not they have really suffered the traumas they claim. Certainly there are some odd things going on. Near Calais, a large group of Iranians and Afghans have long been encamped, refusing to claim asylum until they have reached Britain.

When it comes to student visas, there are incentives to cheat not only for would-be immigrants but for educational institutions too. Harvard University's Mr Borjas explains in a recent article in the *National Review* that 13% of foreign students stay on legally, making a place at an American educational establishment a safer bet for an entry ticket than the 0.5% chance of winning the annual American visa lottery. The incentive for educational bodies of all sorts is that foreign students provide welcome tuition fees and, for universities, cut-price teaching help.

One reason why would-be immigrants choose these roundabout routes to the rich world is that there are few straightforward ones available. Migrating for a permanent job is difficult everywhere. Canada has a

system, copied by Australia, for admitting a few thousand would-be immigrants each year on the basis of points awarded for a variety of characteristics. Increasingly, says Meyer Burstein, a Canadian expert, these reward skills, education, language and youth. Germany and Britain both want to copy Canada's system, whereas Americans think that the job market is the best judge of what is needed. But even in America, says John Salt of University College London, a top expert on migration, “Highly skilled permanent employment-based immigrants account for about 3% of the total number of immigrants.”

Temporary work permits, which several countries increasingly issue, help a bit to fill the gap, but most involve a process of labyrinthine complexity. Often there is a test of some sort to ensure that the worker is not taking a job that a native might fill—usually a meaningless formality, but one of several that allow endless opportunities for bureaucratic delay. That seems even more true for the United States than for Europe. Leon Wildes, the New York immigration lawyer who got John Lennon a work permit in the heyday of the Beatles, taps a vast blue file on his desk. “This is one of my most well-heeled clients. He wants to bring in his household cook. It's taken us four-and-a-half years to get to this point.”



The back door

Because work permits are rarely issued to the unskilled, such people generally have no legal way of migrating to find work. So they come illegally. Immigration controls keep many people out, but not everyone. Vast numbers of travellers enter and leave most countries each year. For instance, although 20m foreigners arrive in Britain each year, Professor Salt's best guess is that Britain's foreign population rose by a mere 134,000 between 1999 and 2000. But even islands will never catch all those with no right to be there: most illegals are visitors who overstay their tourist or student visas.

If a country has a long land border, like the United States, or coasts temptingly near poorer countries, like Italy, its best hope is internal enforcement. That is easier in countries such as Germany, where people have to carry identification and register with the local authorities when they move. But even Germany has asylum-seekers who vanish when their claim is turned down: “We call them U-boats,” says Rainer Münz, a demographer at Berlin's Humboldt University.

Either way, the illegals keep on coming. More than a quarter of America's immigrants, or about 9m people, are probably undocumented: about 60% of them entered illegally and 40% overstayed their visas. Their number grows by at least 500,000 a year, reckons Jeffrey Passel of the Urban Institute. Mexicans are more likely to be undocumented than any other group: the Immigration and Naturalisation Department thinks that 88% of male Mexicans and 73% of female ones entering America have no papers. That compares with 53% of men and 34% of women from the rest of the western hemisphere.

Numbers for Europe are vaguer. Jean-Claude Chenais, a leading French demographer, guesses that Germany has 1m and France up to 500,000 illegals. Jonas Widgren, head of the International Centre for Migration Policy Development in Vienna, thinks that 500,000 illegal migrants enter the EU each year. Most cross land or sea borders illegally, he says, but 150,000 overstay their visas. That implies that the inflow into Europe and the United States is much the same, relative to population: about 0.15% of population a year.

Visit the American-Mexican border patrol at El Paso, and the problem is plain. No border crossing in the world has more sophisticated detection equipment. Cameras monitor remote stretches; a chain-link fence spans miles of scrubland; sensors buried in roads draw attention to suspicious traffic; patrols on horseback and quad bikes sweep the desert, dragging car tyres to smooth the sand and make it easier to spot fresh footprints. For all this expense and the consequent human misery, the patrol reckons it catches six or seven of every ten illegal entrants. A large proportion of the 400 people apprehended each day—and usually released—have crossed, or tried to cross, before.

Thousands continue to climb into the backs of the trucks that carry the world's trade across borders, to the fury of the International Road Transport Union, whose members pay fines or even go to jail when their unwanted cargo is discovered. Many would-be immigrants use the services of a professional smuggler. The rich world's politicians tend to talk of migrants being “exploited” or “victimised” by

smugglers, wilfully confusing them with the traffickers who buy and sell women and children in the sex trade. Some smugglers are undoubtedly ruthless, and becoming more so as smuggling fees rise. But many would-be migrants, having decided to go, seek out the services of a smuggler on a friend's recommendation, rather as holidaymakers turn to a travel agent.

After border checks, the only backstop is internal enforcement. Illegals thrive on vigorous, open labour markets in societies with few internal checks. In a remarkable study of undocumented immigrant workers in London for a conference run by the Institute of Public Policy Research in March, Bill Jordan and Frank Düvell reported an interview with a Pole who had been in London for seven years, during which time he worked (illegally) continuously and trebled his hourly earnings:

> I have been to Germany three or four times ...You earn better money there but there is no freedom: you have to be able to produce your documents at any time, whereas here ...nobody ever asked to see my passport. I would never have been able to live illegally in Germany for so many years.

Internal enforcement inevitably means making employers responsible for ensuring that their staff have a legal right to work. That is possible in Germany, where employers are used to bureaucratic demands. In the United States, Doris Meissner, formerly head of the Immigration and Naturalisation Service, recalls with frustration the impossibility of enforcing effective controls on employers. When the INS inspectors harried them, bosses simply told politicians that without illegals the harvest would rot in the fields. Stephen Castles, director of the Refugee Studies Centre at Oxford University, puts his finger on the problem: “You'd actually have to imprison employers. Would the courts do it?” At present, even fines are rare.

Even if employers could be disciplined, countries would then need to be able to remove those who arrive illegally. This is difficult everywhere. In the spick-and-span El Paso detention centre, America's largest, officials sigh if the courts hand down a deportation order for illegals from Cuba, Iran or Iraq. Releasing the immigrant is far simpler than trying to send him home.

Even if countries could be cajoled or bullied into taking back their strays, no imaginable repatriation policy is likely to evict all illegals, so their reluctant hosts need to find ways to deal with them. The alternative is to put up with an underworld population of non-persons, who may be unable to get car insurance or health care and who may pay no income tax or social-security contributions.

Having become increasingly wary about links between immigration and security, countries understandably feel uncomfortable about the presence of millions of undocumented foreigners. But offer them an amnesty, as America, in effect, did to 3m people in 1986 and Malaysia did in May this year, and you give others an incentive to try their luck. The wiser compromise is to allow those who have found work, paid taxes and avoided trouble to earn the right to stay, rather than force them home to change their status. In general, the benefits of being able to regulate those who have become legal will outweigh the costs of appearing to cave in. “The attitude of the public will depend on how you package it,” says Esther Olavarria, counsel to Senator Edward Kennedy, who is keen to help the undocumented. “If you say it's an amnesty, they'll say no. But if you say, these are hard-working individuals whose position needs to be regularised, they'll support it.”

And rightly. Illegal migrants are the most employment-hungry, market-sensitive arrivals of all. In the United States, points out Roberto Suro, director of the Pew Hispanic Centre, they provide just-in-time labour: “A meat-packing plant in Iowa can say to the foreman, next month we need 5% more workers for three months. On the day they are needed, they'll be there. It's extremely efficient.”

To convince their voters that migration is under control, governments have to curb the illegal sort. But they would be foolish, in doing so, to lose the flexibility and employability that illegals contribute. Better to find ways to allow more to come legally—but not necessarily to stay.

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Feeling at home

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Why some immigrants settle in faster than others

BOTH immigrants and host country often feel ambivalent about the way they live together. Immigrants want to feel at home—but they also want, to varying degrees, to keep their original values and culture. Host countries want immigrants to integrate—but some also harbour a sneaking hope that the newcomers will eventually go home. Pull up too many cultural roots, lose the ancestral language, and that becomes hard.

AP

How to make Americans

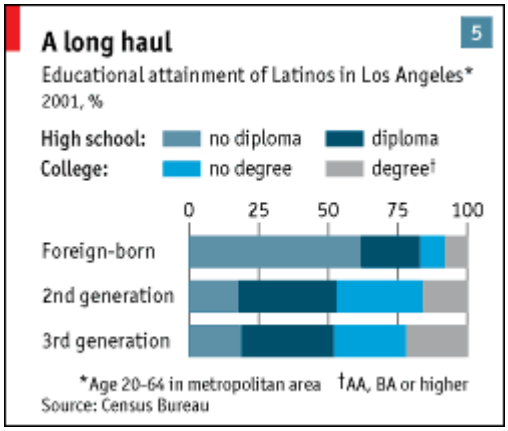
Such ambivalence is greater in Europe than in the United States. Not only does America have an unusually clear idea of what it stands for as a country; it has had enough experience of accommodating different cultures to have created a template for cultural co-existence. Europe lacks both advantages. Europeans often mistrust national pride and lack moral self-confidence; they are also new to the business of living in a multicultural society, and are not helped by the sheer size of the Muslim population in some of their countries.

For instance, what moral values and rules of behaviour should modern societies insist that people share? In the name of protecting freedom of speech and religion, should they tolerate incitement to violence by imams? Pim Fortuyn, a maverick homosexual Dutch politician, raised such questions before he was murdered earlier this year. He opposed immigration precisely because of the clash of values it brought. “Christianity and Judaism have gone through the laundromat of humanism and enlightenment, but that is not the case with Islam,” he said.

Optimists argue that Europe will eventually learn from America. Aristide Zolberg, of the New School University in New York, recalls that the first big crisis in American immigration came in the 1830s when the Catholic Irish began to arrive. Their religious loyalties were assumed to be to a foreign potentate who deplored the liberalism and republican values for which the United States stood: “Everything now said in Europe about the unsuitability of Muslims for life in a liberal democracy was then said about the Irish.” But America's schools and other institutions consciously turn immigrants into Americans.

As long as migrants think they will eventually go home, integration is bound to come slowly. Germany's Turkish guest-workers and their families believed, right up into the 1980s, that one day they would leave. That caused problems: many first-generation Turks sent their children “home” to school, thus ensuring that the second generation was badly prepared for work in Germany. And the Turkish community made fewer demands on its host country than

it might otherwise have done. “Only when Turkish Muslims realised that they would stay in Germany did they begin to build proper mosques and demand religious education for their children,” says Peter Heine, an expert on Islam at the Humboldt University.



In fact, the nature of migration has altered in ways that encourage ambivalence. In the 19th century, the migrant and his family would board a ship for a new land knowing that they might never return home. Now, migration is rarely a single decision, but more often involves a series of steps: a succession of short visits that grow longer; or marriage and the arrival of a child; or a study course that leads to a job that turns out to be permanent.

That should help immigrants to span two cultures. Doing so is easier thanks to modern communications, and works well if immigrants feel welcome and accepted by their hosts. “My concept is of a hyphenated identity,” says Cem Ozdemir, a former member of Germany's Parliament. “I can criticise this country because it's my country—but I'm not a Christian, I was born into a Muslim family, and my mother-tongue is Turkish. I want both sides to accept that.” The hyphen comes more readily to non-observant Muslims like Mr Ozdemir than to young Turks who are captivated by Islam. Germany's Turkish-language press is far more outspoken than anything published in Ankara.

If the second generation cannot define its place in a society that accepts and incorporates cultural diversity, it may become hostile and alienated instead. Immigrants' children, unlike their parents, do not see the new country as the promised land. Moreover, they may well have grown up in poverty. Their parents are disproportionately likely to be in low-wage jobs or, in continental Europe, to be out of work. Migrants are twice as likely as natives to be unemployed in Denmark, three times as likely in Finland and four times in the Netherlands. There is nothing inevitable about such vast gaps: they scarcely exist in America or Australia. But they matter, because of the power of the job market itself to promote integration.

Immigrants' children are also likely to have parents with a poor command of the host country's language. Yet countries have only gradually woken up to the importance of learning the local language for economic and social integration. In California, Ronald Unz, a wealthy supporter of integration, championed a vote against Spanish-language education. Evidence from Britain shows that fluent English boosts a migrant's earnings by around 17% an hour. In Denmark and Britain, legislation will now compel some immigrants to take compulsory language lessons. In Germany, politicians from the opposition Christian Democrats such as Thomas Strobl go further: they want no more immigration until integration is under way. “The key to integration is the German language,” he argues. “Some families have been living in Germany for 30 years, but the children don't speak a word of German when they start school.”

Clusters and children

The young find integration harder when they grow up in segregated communities. Immigrants always converge initially on a handful of cities. William Frey, an expert on social geography at the Milken Institute, talks of “demographic Balkanisation”, with two-thirds of the immigrants who arrived in America in 1985-96 concentrated in ten “gateway” cities from which native whites and blacks move out. The rest of the country, he fears, will look demographically quite different, and be less tolerant of ethnic diversity. In New York's metropolitan area, argues Professor Beveridge, newcomers are far more diverse than at the height of the first great immigration wave, in 1910. Five nationalities then accounted for 80% of immigrants, whereas now 22 nationalities account for only 66%. But they are also more segregated, with Washington Heights dominated by Dominicans, Flatbush by West Indians, Iron Bound by Portuguese and Union City by Cubans. “Will they all be incorporated into the wider society?”, he wonders. “Or will we become a plural society, where each group retains its own identity?”

School is where the melting-pot succeeds or fails. There, a disturbing ethnic divide emerges in several countries: some immigrants' children (usually those of the smaller groups) do far better than others. In the United States, concludes a recent study of more than 5,200 second-generation children in Miami and San Diego, the children of Chinese, Korean, Vietnamese, Laotian and Cambodian immigrants had grade-point scores averaging at least twice those of Mexican and Cuban children—even after adjusting for family and school characteristics. In Germany, it is the children of the Turks who cause concern: only 8% of Turkish children pass the Abitur, the tough German high-school-leaving exam, compared with 12% of the children of all foreigners and 30% of Germans. In Britain, the children of East African Asians thrive at

school; Bangladeshi kids struggle.

Why these differences? Much of the answer is parental background. Britain's East African Asians were mainly urban professional Gujarati Hindus and Punjabi Sikhs, fleeing Uganda's Idi Amin. Most of them were English-speaking. All this seems to benefit their children educationally.

By contrast, an immigrant child such as Mr Ozdemir had some of the same handicaps as America's young Mexicans or France's Maghrebis. He had to repeat first grade because his German let him down, and his Turkish-speaking parents could not help. “The hardest kind of immigration you can have”, he says, “is from a rural area to a complex modern society.” It is even tougher when the low wages that make unskilled immigrants so attractive to employers condemn their children to poverty and struggling inner-city schools.

In Los Angeles, Joy Chen, a second-generation immigrant, the daughter of an MIT-educated Chinese father, is deputy mayor. She waves a sheaf of charts showing that the Latino population of the city has outstripped the white; that the new jobs for which demand will grow fastest will require a college degree; and that only one in ten Latino youngsters completes college. That is half the rate for the city's blacks.

Still more alarming is the performance of the immigrants' grandchildren. Of foreign-born Latinos, 35% have no more than a sixth-grade education, and another 27% do not finish high school. The comparable percentages for second-generation Latinos born in America are 1% and 17%. But for the third generation, they are still 1% and 19%. “By this time,” says Ms Chen, incongruously, “they're us.”

Not surprisingly, then, the children of the educated and skilled rise more easily through the educational system of their new country than the children of the rural unskilled, and the second group has problems in the job market. The children of the unskilled, unlike their parents, are not keen to work for low pay in jobs that natives shun. After all, they are natives too. And two-thirds of them had hoped for a college degree and a professional job. Instead, a disproportionate number of second-generation youngsters are out of work. Add in discrimination by employers and competition from new waves of immigrants, and their job prospects are often even bleaker than those of the unskilled children of natives. With aspirations far outstripping their qualifications, many immigrant children feel alienated. “Petty crime is linked to immigration,” admits Claude Bertrand, deputy mayor of Marseilles. “The reason is that the young do not feel part of society—or, when they do, it's at the lowest level.”

Some Americans wonder whether the United States may be treading the same unfortunate road as Europe did in the 1960s, importing low-wage migrants to do industrial jobs. Now those jobs have gone, but the migrants are still there, trapped, with difficult consequences for their children. Because one-third of America's Latinos are under 18 years old, the future of the next generation is a social issue of crucial importance. For them, there is no simple route back. As Mr Suro from the Pew Hispanic Institute observes, “They will grow up just about the time the baby-boomers retire. So we have four to five years left to deliver the workforce we want by late this decade. If we have only a 60-70% success rate, we will double the poverty class.”

Such fears raise the most difficult question of future immigration policy. Easily the biggest economic gains from migration arise from allowing the unskilled to move from poor countries to rich. But easily the biggest challenges of integration, and the highest costs, arise if the unskilled settle down and have children. If society fails to integrate the next generations, those costs may stretch far into the future.

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The view from afar

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Emigration also affects those left behind

WHEN, in 1990, Mary Robinson became president of Ireland, she gave an inaugural address in which she described herself as a leader of the Irish throughout the world. “Beyond our state, there is a vast community of Irish emigrants,” she said. “I will be proud to represent them.”

More and more countries lose people to migration, as Ireland has done for so long, and therefore have a large diaspora living beyond their borders. They may play a part in their former country's politics, because many emigration countries allow dual citizenship. They may also be an economic force. Although migration is often disruptive and harmful for the sending country, the creation of new, trans-national communities may also bring opportunities for gain.

Earning power 6

Workers' remittances and net foreign aid, $m selected countries

	1996		2000	
	Remittances	Aid	Remittances	Aid
Albania	500	228	531	319
Bangladesh	1,345	1,236	1,958	1,171
Brazil	1,866	288	1,113	322
Colombia	635	189	1,228	187
Croatia	603	133	531	66
Dominican Rep	914	100	1,689	62
India	8,453	1,897	9,034	1,487
Mexico	4,224	287	6,573	-54
Morocco	2,165	650	2,161	419
Sudan	220	220	638	225

Sources: IMF; OECD

The losses are obvious. Those who leave are often the best-educated and most enterprising. Remzi Lani, director of Albania's Media Institute, bemoans the brain drain that has stripped his country in the past decade. “All three AIDS experts have gone to Canada,” he says. “The best brains go and don't come back. We have lost one in six of the population—almost one person per family. There are 8,000 Albanians studying in Italian universities—more than in Tirana University. How many will return? Not more than 5%.”

Not only does emigration deplete a country's intellectual capital and energy, it undermines the tax base too. A recent study of the fiscal impact of India's brain drain to America, by Mihir Desai of Harvard University and two colleagues, found that the very best people were most likely to leave. There were 1m Indians living in the United States in 2001, and more than three-quarters of those of working age had a bachelor's degree or better. The earnings in the United States of a group that adds up to 0.1% of India's population are equivalent to an astonishing 10% of India's national income. The net fiscal cost to India of losing these prime taxpayers, say the authors, was 0.24-0.58% of GDP in 2002.

If poor countries had a glut of overeducated, underemployed workers, then the loss of human capital might not matter much. “Most people who leave say that their skills aren't properly used,” says Georgetown's Ms Martin, who argues that such countries might do better to train more people to carry out primary care than to produce expensive doctors. But others argue that seeing highly trained people getting lucrative jobs abroad may persuade youngsters to train too, thus raising a developing country's skill levels.

As rich countries compete for skilled immigrants, development experts worry about the implications. Britain's Department for International Development teamed up with the International Labour Office in Geneva last year to produce a report which found that some developing countries had lost around 30% of their highly educated workforce. However, it argued, international migration generally benefits developing countries, as long as host countries take steps to reduce harm—by, for instance, encouraging migrants to return. And some developing countries are actually keen to have more skilled emigration, argues Allan Findlay of Dundee University, one of the authors of the report. Indeed, India, which produces more highly qualified people than it can employ, is campaigning for migration to be covered by the General Agreement on Trade in Services, part of the current round of international trade talks.

How does migration benefit the sending countries? The most obvious way is through remittances. In Albania, receipts from remittances amount to 75% of its exports of goods and services (with the unwelcome result that its currency is one of Europe's strongest). All told, IMF figures suggest that

developing countries receive more than $60 billion a year in remittances. That is $6 billion more than net official aid from OECD countries.

The sheer scale of these flows has prompted interest in the way they are transmitted and deployed. Even such a simple thing as sending money is difficult when an undocumented immigrant cannot open a bank account. Many migrants' families live in countries where the financial system is untrustworthy. Sending them cash became harder after the purge on unofficial channels of money transmission after September 11th.

All this has been a bonanza for the few companies, such as Western Union and Moneygram, that offer reliable money transmission, although at a high cost. It is not unusual for 25% of an immigrant's remittances to be eaten up by fees and poor exchange rates. Now there is a drive in America to start credit unions to do the job more cheaply. And a few banks are competing. For instance, Wells Fargo offers a remittance account in the United States that allows an immigrant's family to draw money from a matching account offered by Bancomer in Mexico. Jane Hennessy, who runs the bank's remittance services, says that Wells Fargo is now piloting a way for immigrants to pay cash into a branch in the United States that can be withdrawn immediately as cash in Mexico. One attraction for undocumented workers is that the bank will accept Mexican identity papers and does not require a passport or American driving licence.

The families that get these remittances often spend them on housing, durable goods and health care. The economy gains if such goods and services are locally produced: on one estimate, each dollar sent home generates three to four dollars of economic growth. Sometimes immigrants from a particular village team up to pay for a septic tank or a school. To channel remittance money into government-approved development projects, some countries try to lure immigrant cash into special bonds. Much of the money flowing back to Central America has gone to rebuild countries shattered by civil war or natural disasters.

Remittances tend to decline over time. But there are other, more subtle ways that emigrants may help the folk back home. For one thing, their departure will change relative wages. If the proportion of skilled people declines, the pay of those who remain may rise. Ioan Mihailescu, rector of Bucharest University and co-author of a UNESCO study on the impact of the brain drain on the academic labour market in south-east Europe, points out that in 1995-97 half his newly graduated physics class left the country, mainly for the United States, whereas last year fewer than 10% of physics graduates went. He thinks this is because jobs for the highly skilled have expanded as the economy has prospered, and pay rates in Romanian companies for people with scientific and technological skills have doubled or trebled over the past eight years.

Don't emigrate, circulate

If immigrants return, they bring back new ideas and skills. A study by Alan Barrett of Dublin's Economic and Social Research Institute looked at returning immigrants to Ireland. It found that male graduates who lived abroad for at least six months after getting their degrees, and who went abroad for work rather than fun, earned 15% more on average than other Irish men with similar qualifications when they came home. Sadly, those who went merely for adventure earned no such premium, and neither did women.

A recent survey by AnnaLee Saxenian for the Public Policy Institute of California of more than 1,500 first-generation Indian and Chinese migrants found that “brain circulation” is a more appropriate way to describe what is happening to these groups in Silicon Valley than “brain drain”. Of those surveyed, 50% go back at least once a year to their home country on business, and 5% return at least five times a year. Even more telling, 74% of Indian respondents and 53% of Chinese ones said they hoped to start a business back home.

Such findings suggest that industrialising countries should try harder to entice back the intellectual and financial capital of their departed migrants. Some already do. Pam Yatsko, author of “New Shanghai: the Rocky Rebirth of China's Legendary City”, reports a succession of job fairs in Silicon Valley, often sponsored by China and aiming to woo back high-tech migrants to start companies in Shanghai's Pudong district. America's technology slump has helped. “People will take the jobs because they know that the cost of living is less in Shanghai, and they can get good domestic help,” she says. “Also, those who stayed in China made oodles of money.”

Even if migrants do not return for good, there are still ways to harness their skills. One that is gathering favour involves using the Internet to create networks of expertise and business contacts. Mercy Brown of

South Africa's University of Cape Town has tracked down 41 diaspora networks, tied to 30 different countries (disappointingly few of which are in Africa). Some, such as the South African Network of Skills Abroad, embrace people who are not from South Africa but simply interested in the country's development. Most are strictly for the brainy, and especially those with scientific and technological know-how. All aim to offer a way for expatriates to help with development.

Other immigrants may travel back and forth between sending and host countries, creating trade and business opportunities as they go. Aissa Goumidi in Marseilles is typical. His textile emporium is an Aladdin's cave of glowing brocades, sultry velvets, sequins and lace. Every metre is sold to merchants in his home country of Algeria. Two of his sons work in Algeria, helping to run his bottling plant and hardware factory there. Only his youngest son, still in Marseilles, is a worry: “He would rather learn English than Arabic,” he complains.

In the same city, Mohamed Laqhila, an accountant and second-generation migrant, wants to build on these relationships. He has been bringing people from accounting institutions in the Maghreb countries to discuss investment opportunities in their region with his contemporaries in France. He wants to see a progression, from the first generation that sends back remittances, through the second that sells the family home and brings the cash back to France, to the third that should start to put something more permanent back into the development process.

From all this, a common point emerges. It is in the interests of the sending country to keep in close touch with its émigrés, and to retrieve them if possible. That may not always suit the immigrants or their employers, but it may also be in the interests of host-country governments. Here, surely, is scope for a common policy.

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A modest contribution

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On balance, host countries benefit only slightly from immigration, whereas immigrants benefit hugely

“LET me tell you the problem,” says Victor Trevino, Mexico's deputy consul in the border town of El Paso. “The minimum wage in the United States is $5.15 an hour. In Mexico, many people earn $5 a day. In a supermarket here, a gallon of milk costs $3. Across the border, in Juarez, it often costs 10 or 15 cents more.” No wonder they come. But what do the people in the host country gain?

Magnum

The locals didn't want the job

For most people, this question revolves around tax and welfare benefits. Do immigrants come to scrounge? Or will they be the salvation of rich countries that have promised their citizens pensions that the public purse cannot afford? There are wider questions too. Do immigrants depress the pay of native workers? Do they retard the growth of productivity? Or do they bolster global economic growth? To such questions, the answer is mostly an unsatisfying “it all depends”.

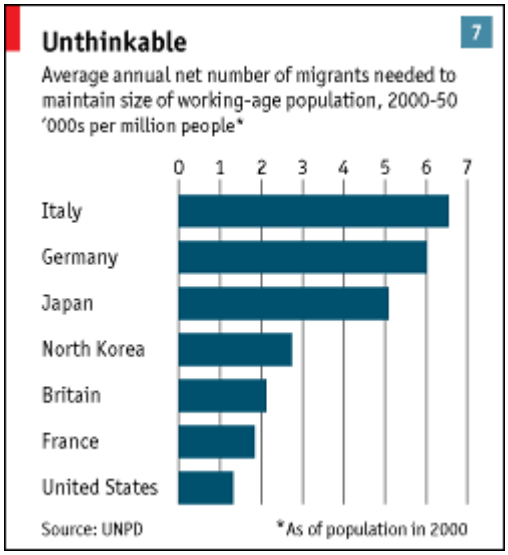
Take tax and welfare first. Asked whether he thought that the United States should open its borders to all comers, Milton Friedman, the grand old man of liberal economics, replied: “Unfortunately not. You cannot simultaneously have free immigration and a welfare state.”

At a given moment, migrants are generally net contributors to the public purse: they are disproportionately of working age, and the receiving country has not had to pay for their education. A study by Britain's Home Office estimated that the foreign-born population paid about 10% more to the government than it received in expenditure. However, a magisterial study in 1997 of the economic impacts of immigration, by America's National Research Council, found that the picture changes if one looks across time instead of taking a snapshot. In that case, the NRC found, first-generation migrants imposed an average net fiscal cost of $3,000 at present discounted value; but the second generation yielded a $80,000 fiscal gain.

Some immigrants contribute more than others. Those who come as students or relatives or asylum-seekers (as most do) may not work at all—or may not be allowed to work. In addition, immigrants tend to have larger families, to be poorer and to be more often unemployed than the native-born. The report for the Fondazione Rodolfo Debenedetti found that, in some European countries, such as Denmark and the Netherlands, welfare benefits were so generous that they probably distorted the inflow of immigrants and encouraged them to draw welfare.

As with so many other aspects of immigration, skill levels affect costs. Migrants from poor countries are much more likely to claim

benefits than migrants from rich ones; unskilled migrants are much more likely than natives or skilled migrants to lose their jobs in a recession. And countries treat different classes of immigrants in different ways for welfare-benefit purposes. Asylum-seekers in the United States cannot claim welfare during the six months in which their claim is normally determined. In Germany, by contrast, asylum-seekers can claim welfare benefits while their asylum claim is processed. That can easily take years, during which time they may not be allowed to work if they have been sent to live in an area of high unemployment.



Even if immigrants pay more tax than they get back in public spending, they may create some imbalances on the way. The tax they pay may go to the national government but the spending may burden a city or state, which houses and educates them and their children. The NRC study noted that the fiscal gain from immigrants was spread fairly evenly across the United States, but that the burden on states varied, depending on the type of immigrants they attracted. In 1989-90, in New Jersey, where almost half of new immigrants are from Europe or Canada, native households paid a net $232 a year more because of immigration; in California, where more than half of all immigrants come from Latin America, they paid $1,178 a year more.

Immigrants are on average younger than the native-born, and they have more children—partly because of their ages, but also because they usually come from countries with higher fertility rates. Fertility in most rich countries, and especially in Europe, is below replacement level, so their populations will age and shrink over the next half-century. For instance, the median age in Italy may rise from 41 today to 53 in 2050. By mid-century, the population of Spain may be 22% smaller than it is now, and that of the Netherlands 10% smaller. All told, by 2050 no fewer than 34 countries will face a decline in population.

Buying youth

Two years ago, the United Nations Population Division tried to establish what levels of immigration might be needed to prevent such a population decline, and what might be required to maintain the existing ratio of workers to those needing support. Its findings produced international uproar. “Quite a lot of my colleagues had to cancel their holidays when the report came out,” says Joseph Chamie, head of the division. Not only did the levels of migration needed to stabilise the working-age population turn out to be large, but the flows needed to stabilise the present support ratio proved to be immense, at least in Europe. The EU would require an annual inflow of nearly 3m migrants a year, or roughly twice the present legal and illegal flow from outside the EU, to prevent the future support ratio (of those aged 15-64 to those aged 65 and over) dropping from about four at present to below three. In the United States, where the support level is currently above five, it would take just under 1m immigrants a year (or about two-thirds the present inflow) to stabilise at three.

Would it help to increase the proportion of the working-age population who actually work? Yes, said the report, but only up to a point: even if everyone of working age were in work, support ratios in 2050 would still drop below three even in the United States. Only by raising the retirement age to 75 could current support ratios be maintained.

For Europe, these calculations offer an uncomfortable reminder that its population may have peaked around 1997 and may now be declining. America's population, by contrast, will grow over the next half-century, perhaps by 40%—and four-fifths of that growth will be due to today's immigrants and their descendants. Numbers count, and Europe's resistance to immigration may count against it.

Certainly, ageing countries will attract immigrants. Demand from older people for labour-intensive services will drive up the wages of the unskilled. The choice for Europe's old may be between being cared for by legal migrants or illegal ones. However, immigration is not a solution to the strains that ageing will bring. For one thing, by 2050 fertility rates will have dropped below replacement levels even in many traditional emigration countries, including Mexico, Egypt, Brazil, the Philippines and Indonesia. If young people continue to leave these countries in large numbers, supporting the elderly there will one day become an even bigger problem than in the rich world.

Besides, young and fertile migrants grow old and their fertility rates rapidly decline. “There are no

feasible migration solutions to the age-structure change and its effects on social security," insists David Coleman, a demographer at Oxford University, who argues that integrating the existing foreign-born and their children should come first.

However, in one respect immigrants may make a substantial difference. The ageing countries of Europe face an unsustainable gap between future tax revenues and commitments to spend and to service government debt. In Germany, for example, that prospective gap is of the order of an annual 6% of GDP. If migrants make a net contribution to taxes over their lives, they reduce that debt. But even if they do not, argues DIW's Mr Brücker, they increase the number of future taxpayers. The same debt spread over more payers automatically reduces the individual burden of future taxpayers. In short, migration cannot prevent ageing, but it can significantly reduce its fiscal consequences.

To sum up, immigration changes both the size of a country's economy and the way the gains are shared out. Measurement is difficult, and results often disagree. But a number of broad conclusions emerge from all this.

First, migration probably raises the living standards of the rich (think of all those foreign nannies and waiters) and the returns to capital (hence the enthusiasm of employers for more flexible policies). It does not seem to increase unemployment among the native-born, although it may reduce their pay.

On balance, argued the report by America's NRC, the people whose wages immigration harms are mainly previous immigrants, for whom new immigrants are close substitutes in the job market. In addition, immigration seems to account for almost half the fall in wages of high-school drop-outs in the 1980s and early 1990s. But this is a smallish group, now less than 10% of the American workforce. Trade unions in the United States no longer argue for a ban on immigration, realising that this is a lost cause: instead, they want to legalise the undocumented, who are much more likely to undercut their less-skilled members than are unionised legal immigrants.

The effect on jobs depends partly on whether immigrants are complements to or substitutes for native labour. Are the immigrants doing jobs that natives might have done, or would those jobs simply not exist if immigrants were not there to do them? Advertise for a cleaner in London at twice the minimum hourly wage, and you will get no response from local school drop-outs or Liverpool's unemployed. More probably, the applicants will be from Ukraine, Colombia or Poland.

Some labour economists are puzzled that immigration does not appear to have made much impact on wages or jobs. Trade economists such as Berlin's Mr Brücker are not. They point out that an open economy may change its mix of output, leaving wages and unemployment unaltered. Indeed, in many countries, immigrants are densely concentrated in export industries such as textiles, car making and agriculture.

Immigrants also cluster in areas where the job market is tight. In Canada, half of all immigrants go to Toronto; in Britain, an even higher proportion settles in London. Harvard's Professor Borjas points out that immigrants incur much lower costs than natives in choosing to move to a particular place, because they have already decided to uproot. They gain the greatest benefit by moving to those places where their skills are in greatest demand. Not surprisingly, he finds that new immigrants are disproportionately clustered in America's high-wage states, where workers are scarcest.

That clustering helps to stop wages rising even further, and allows the entire economy to run at higher speed than might otherwise be possible. The finding has important consequences for Europe, with its lower geographical mobility and more inflexible job markets. There, the importance of immigrants as a flexible workforce is potentially even greater than in the United States.

Immigrants may boost economic growth in other ways that are harder to measure, and that depend on their skills and experience. They may bring entrepreneurial skills: almost 30% of new companies in Silicon Valley in 1995-98 were started by Chinese and Indian immigrants. Some depressed regions actively court immigrants: the chamber of commerce at Nashville, Tennessee, sees them as a source of dynamism, as does Tom Vilsack, the governor of Iowa, whose state has a meat-packing industry relying largely on Bosnian refugees.

Against that, unskilled immigrants may discourage investment. Mr Krikorian, of the Centre for Immigration Studies, argues that productivity in California's raisin industry is far lower than it could be, because of the ready supply of cheap illegal Mexicans to pick the fruit by hand. Australia, with far fewer illegals, grows grapes over trellises, which allows automated harvesting.

As far as the host country's population is concerned, then, the benefits of immigration may be modest and unevenly distributed. The NRC study estimated them at up to $10 billion a year—chickenfeed in an economy of $10 trillion. “The economic pluses and minuses are much smaller than the political and emotional salience,” says Rand's Mr Smith. In Europe, where they have been less carefully measured, they may be larger: Britain's government recently increased its underlying forecast for economic growth by a quarter of a percentage point because it now expects higher net inward migration.

Greatest good for the greatest number

For the individual immigrants, on the other hand, the potential gains are very large. This explains why many trade economists argue that humanity as a whole benefits enormously from migration. Alan Winters of Britain's Sussex University, in a study for the Commonwealth Secretariat, has tried to quantify these gains. He concludes that, if the rich countries raised the number of foreign workers that they allowed in temporarily by the equivalent of 3% of their existing workforce, world welfare would improve by more than $150 billion a year. That is bigger, he points out, that the gains from any imaginable liberalisation of trade in goods.

Dani Rodrik, a trade economist at Harvard University, has independently reached similar conclusions. Gaps in the prices of traded goods have become much smaller after many years of liberalisation. Not so gaps in the wages of similarly qualified individuals in different parts of the world. So the gains from liberalising immigration restrictions are vastly greater than those from further freeing the movement of goods or capital.

Both Mr Winters and Mr Rodrik agree that the biggest gains are from freeing the movement of unskilled rather than skilled labour, for there the wage gaps among countries are greatest. In addition, the loss of skilled people may do greater damage to the developing countries that have trained them. So both economists independently reach another conclusion: to minimise harm to sending countries, migration should be temporary.

More migration will not be popular. But neither, says Mr Rodrik, is liberalising trade. And indeed, the plight of the miner in Wales or the farmer in Japan whose way of life is destroyed by cheaper imports is not so different from that of the old lady in downtown Los Angeles whose neighbourhood has become Hispanic. All, in different ways, are victims of the march of globalisation. The best remedy is to redistribute some of globalisation's gains to its victims.

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A better way

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Managing the market

Panos

Just one chance, please

HOW can governments develop immigration policies that reap the potential gains without incurring too many political costs? The challenge is to manage the market, not to strive vainly to shut it down. Voters may not like immigration any more than other aspects of globalisation, but they are more likely to tolerate it if policy appears to be orderly rather than chaotic. Legal immigration is easier to regulate than illegal, and more likely to bring benefits in the long term. The thousands of people who today immigrate illegally are condemned to a shadow world of lies, fear and powerlessness. No liberal democracy should tolerate that.

Winning consensus for an orderly policy may mean trying to pick the migrants most likely to bring economic and social gains. For the host country, this means choosing the skilled. It may also mean (although liberal democracies detest the implications) choosing those whose education and culture have prepared them for the societies in which they will live. In Europe, that may mean giving preference to white Christian Central and Eastern Europeans over people from other religious groups and regions.

What about asylum-seekers and family reunion? The main convention under which asylum-seekers claim rights of entry dates from 1951, when Soviet border guards shot people who tried to leave, and the West could afford to be magnanimous. Now, settling asylum-seekers has become vastly expensive: for example, the cost to British taxpayers last year was at least £1 billion ($1.5 billion), the equivalent of one-third of the country's official aid budget. Is that money best spent on the 76,000 people a year who ask for asylum in Britain, or on the millions in refugee camps in countries such as Pakistan and Uganda? And are those few who make it through the Channel tunnel really the ones most in need of protection, or are the people in the refugee camps at greater risk?

As for families, it may be hard to deny somebody who has become a citizen the freedom to choose a spouse from anywhere in the world, or to invite an elderly parent to move in. But countries could at least insist on a working knowledge of their language, and could give priority to adult relatives with skills.

Legalise and regulate

Wherever possible, policy should be guided by three main principles. First, it should be multilateral, or at least bilateral. Immigration policies drawn up by rich countries without the active co-operation of poor countries are unlikely to work. Second, it should apply economic instruments. Whereas trade restrictions have shifted from quotas and bans to more transparent tariffs, no such change has taken place in immigration policy. Third, it should aim for the maximum freedom of movement, but encourage temporary more than permanent movement.

Migration, like other aspects of globalisation, is more manageable when countries work together. Some argue that migration policy should resemble trade policy in other respects too: it should have a central rule-setting body, like the World Trade Organisation, and should be made on a most-favoured-nation basis, so that countries do not offer one partner concessions they are not prepared to extend to all. This would be hard for voters to swallow. The experience of the European Union shows that countries find it almost imposible to arrive at common immigration rules, even when free movement of labour among their own citizens makes such rules essential.

However, countries could make a number of reciprocal concessions, such as removing all controls on the movement of labour among countries with similar levels of income per head. The fastest growth in foreign trade has been among countries with similar levels of income; the same may well turn out to be true of the movement of labour, although not of permanent migration. Certainly, it makes no economic or social sense for Canadians to stop Australians or New Zealanders from looking for jobs, or for Europeans or Japanese to put obstacles in the way of Americans. Nor does it make sense for developing countries to keep out each other's would-be workers. By removing travel and work restrictions on each other's citizens, developing countries would be enriched, not impoverished.

Wealthy host countries also need to talk to their poorer neighbours whose workers try to cross their borders. Joint solutions have a better chance of success than unilateral ones. So George Bush has been unwise to leave Mexico in limbo, instead of completing the deal he had begun to hammer out with Vicente Fox. “We want to regularise the Mexicans who have already gone to the United States, and channel future flows,” says Gustavo Mohar, who heads negotiations for the Mexican Ministry of Foreign Affairs.

One possibility that Mexico has discussed with the United States is that of imposing a fee on temporary workers: “Pay, and go legally,” suggests Mr Mohar, pointing out that the services of a trafficker can now cost up to $1,000. Mr Massey's book suggests a $300 fee per visa for a temporary worker. Financial incentives are rarely considered as part of migration policy. Yet the sums that people pay to travel illegally, and the fact that most benefits of migration accrue to the individual, strongly suggest that such devices should have a role.

For instance, a fiscal instrument might replace the economic needs test, so often used to keep out immigrants whose skills are already available locally. That test, says Mr Winters in his paper for the Commonwealth Secretariat, is like the crudest form of protectionism: prohibiting imports of goods where local supplies are available. Given the lack of evidence that immigration harms jobs, such tests are pointless. They are also cumbersome to administer.

In fact, the best judge of economic needs is the market. But, to reassure the hesitant, all employers might be asked to pay a levy—perhaps in the form of a higher rate of payroll tax—to employ foreign-born workers. A scheme of this sort has been suggested by Senator Phil Gramm, partly in order to pay for immigrants' health costs. Some money might equally well go into the social-security funds of immigrants' sending countries. After all, emigration leaves them with fewer workers to pay for supporting the elderly.

Many of the economic gains from mobility do not require migration to be permanent. Indeed, if workers leave only temporarily, the sending country gains the stimulus that they bring on return; the host country avoids the fiscal and social costs of assimilating their families; and the migrants may be more likely to continue sending money home while they are away. America's H1-B visas for skilled workers might serve as a model: they can run for two three-year periods, giving both workers and employers time to decide whether they would prefer a permanent arrangement.

Cheap international transport and communications make it easier for workers to go abroad for short spells. Salah Bariki, a community organiser in Marseilles, describes what happens in his local barber's shop. “The guy who runs it comes from Algeria,” he says, “He has a different bunch of lads every couple of months. They come over from the same village on tourist visas and take it in turns.” That pattern fits the lives of many migrants, and especially the unskilled.

However, as the example of Mexico's immigrants demonstrates, the tougher border controls become, the less likely migrants are to go home when their work is done, and to incur the expense and danger of another crossing. When governments design immigration controls, they should bear such perverse effects in mind. They might also ask immigrants to buy a bond—priced slightly above the smuggler's going rate—to enter the country legally. The bond would be repaid to the migrant on return to his own country. The governments of sending countries might play a role too: Harvard's Mr Rodrik suggests giving them a quota for migrants that is reduced by the numbers that fail to return on time.

Such policies may not end illegal immigration, although they would certainly remove some of the pressure. Nor will they stop all temporary workers from staying on. Past experiments with guest workers should restrain expectations: “I would be satisfied with a 65% return rate,” says Mr Rodrik. But they offer hope. They hold out the possibility that the poor might earn money in the job markets of the rich, to the benefit of both, without creating all the social problems that the past half-century of immigration has entailed.

Just as reducing the constraints on trade in goods made the world richer in the second half of the 20th century, so reducing the constraints on the movement of people could be a powerfully enriching force in the first half of the 21st. But in democracies, governments cannot force policies on resistant citizens. Some countries will always try to minimise immigration, and will be the poorer for it. Conversely, countries that accept change will be rewarded with a more vibrant and better-off society, even if they have to accept social changes that they may not welcome. Immigration is always a gamble. But when it goes right, everyone wins.

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Management consulting

Consultant, heal thyself

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Alamy

The strategy-consulting industry is wasting away. Is there a cure?

IT IS as if a neutron bomb has hit the consulting industry. Pay a visit to your local management-consulting shop, and you will find that the building is intact but many of the people are gone. See the rows of empty desks, once filled with eager young MBAs. Read plaintive postings on *www.vault.com*, a yuppie website devoted to the rants and raves of the downturn. Listen to consultants, poor things, complain about having to work for nothing.

The past 12 months have been an *annus horribilis* for strategy consultants—the sort that advise top bosses on the bigger issues facing their firms. McKinsey, the most patrician of the lot, has been mocked for its advice to Enron, Global Crossing and Swissair, all of which have gone bust. The elite strategists at Bain face a continuing lawsuit in Boston over claims that, in the late 1990s, they provided two distinct reports, one for a former boss of Club Med and another for some board members who tried to oust him. Earlier this year, Arthur D. Little, arguably the first strategy-consulting firm, collapsed after management had let costs in its research and development projects soar out of control.

Compared with accountants, law firms and share analysts, consultants have at least escaped the most serious charges of abetting the bull-market misdeeds of America's former corporate darlings. Perhaps rightly, since consultants lay claim only to their wonky ideas and advice, rather than responsibility for execution.

Even so, this year is likely to be a disaster for billings. Some firms, including McKinsey, have called on partners to put up extra capital. To be sure, the economic downturn has depressed corporate spending. Yet companies struggling with a dismal economy presumably need advice now more than ever. So why, since the peak in 2000, have top consultants cut staff by up to one-third? (There are no precise numbers: these experts in “organisational change” are loth to admit “downsizing” of their own.) By one estimate, revenues at the top firms are shrinking by 10% a year. From this depression, predicts one firm's analysis, the industry will return to its late 1990s levels only in 2007.

One reason is the aftershock of the dotcom boom, which led headcounts at the top-tier firms—McKinsey, Boston Consulting Group, Bain and Booz Allen & Hamilton—to double after 1994. Despite many lay-offs, says Ken Favaro of Marakon, another strategy consultancy, the industry still has perhaps 30% overcapacity.

Worse still is the crisis of confidence in consulting, according to Jon Moynihan, boss of PA Consulting, a British management- and technology-consulting firm. He says that clients feel betrayed by some consultants' past advice to spend heavily on dotcom projects. It seems they are now wary of the latest

bright ideas of even the best strategic firms—if there are any.

Nowadays, strategy firms are fighting like wildcats for any available scraps of business, pursuing clients they would once have shunned and even offering to work practically *pro bono*. As clients bargain for lower fees, some consultants have taken on less lucrative work for governments, especially America's, which is increasing its demand for consulting.

What does the future hold? Even as “pure” strategy projects suffer, the broader range of consultants seem to be thriving. Accenture, a huge consulting outfit specialising in IT installations and outsourcing, had a stellar summer. Human-resources and pension consultants have prospered, thanks to a move towards outsourcing. When confronted with the choice of a one-stop shop or a specialist boutique, more clients are opting for focus.

The stockmarket bubble disguised a long-term decline in the appetite of many firms for core strategic consulting, which prompted consultants to move into more marginal activities. Especially in America and Britain, booming capital markets tempted strategy consultants to take on investment bankers in areas such as advising on mergers and acquisitions. But this business, too, is now depressed.

The underlying problem facing strategy consulting is now impossible to ignore. It has its origins over 20 years ago. Today's big strategy consultants rode to their current fame on the back of three forces. One was the rise of the personal computer, which allowed the greenest business-school graduate to analyse any firm's performance using fancy statistical tools. Another was the emergence of a new quasi-science of management, with readily marketable ideas, such as those of Harvard Business School professor Michael Porter, whose “five forces” approach is now taught to nearly every business-school student. A third was the appearance of a competitive threat to American firms from Japanese companies. This so scared American bosses that they were willing to pay a fortune to any consultant bearing a solution.

Strategy has now become almost a commodity. A boom in business-school graduates means that every new manager is well-versed in the latest academic ideas. Top strategy firms' alumni have been very successful in bringing, say, the “BCG way” with them to their new employers. The advice of a management consultant has lost its mystery. Thanks to all this, says Robert Bontempo of Columbia Business School, management consultants may no longer have a profitable business model.

Blown to bits

Might the top firms disintegrate? When Arthur D. Little went bust, its various practice areas were snapped up by the proliferating niche consultancies, which range from energy specialists to economic and technology firms. If being a partner of a big strategy consultant increasingly means giving more money and taking less, partners (actual and potential) may conclude that they are better off in a niche of their own.

There is little doubt that strategy consultants will always be around, in some form, even if the firms are never again as big as they were two years ago. Chief executives, no matter how highly paid, will always be willing to cough up for a bit of hand-holding, as well as somebody to blame for painful decisions or when things go awry. Independent strategic advice may be in greater demand given the growing calls for good corporate governance and scrutiny of conflicts of interest.

Finding the next big idea might help, though after fads ranging from “business process re-engineering” to “the war for talent” to “Internet time”, it will be a tough sell. What sort of idea might emerge next? Partha Bose, of Monitor, another consultancy, sees consultants becoming more like poets and psychologists, peering into the minds of customers, and less like the spreadsheet geeks of yore. Consultants may find rich pickings in the increasingly fashionable fields of “behavioural” economics and finance, which are based on rigorous study of human behaviour.

The consultants have every incentive to find good (ie, marketable) new business ideas. Perhaps, says Mr Bontempo, strategy firms will emerge from the crisis looking more like think-tanks, spreading the best management ideas, without invading clients' offices with armies of billable 20-somethings. Yet, as think-tanks are typically rich in ideas, but poor in profits, the consultants had better hope for a more lucrative destiny than that.

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Satellite television

Hit or bust

Oct 31st 2002 | NEW YORK
From The Economist print edition

EchoStar may have lost DirecTV to Rupert Murdoch

Reuters

Rupert Murdoch's unhidden hand

MICHAEL POWELL, head of America's Federal Communications Commission (FCC), did not mince his words when he blocked the $18 billion merger of EchoStar and Hughes, two big satellite-TV companies, on October 10th. This week, EchoStar made one final attempt to get its deal approved. But it now looks as if Charlie Ergen, the former professional blackjack player who founded EchoStar from the back of his pick-up truck, may have finally bust his hand.

Curiously, the FCC's objections are based entirely on the merger's likely impact on competition. Mr Ergen had presumed, not unreasonably, that competition-policy matters were being looked after by the competition guardians in the Department of Justice's antitrust division, which has also been reviewing the merger. He also presumed that Justice Department officials would make their ruling first, as that is the way it had worked in the past. Wrong again: like his father, Colin Powell, America's secretary of state, Mr Powell junior seems to pursue a doctrine of pre-emption. Despite last-minute appeals from EchoStar and Hughes, the FCC made its antitrust ruling (based, meticulously, on Justice guidelines) before Justice Department officials even had a chance to mutter “Herfindahl Hirschman Index”.

Neither EchoStar nor Hughes would comment on the plan Mr Ergen brought to a meeting with the Justice Department on October 28th. But it was inspired by an idea floated at the FCC earlier this year by Cablevision, a second-tier cable-TV operator that had sniffed a serious opportunity. The merger of EchoStar and Hughes, which owns DirecTV, the biggest satellite-TV service, would shrink the number of satellite-TV operators in America from two to one. The plan was to turn Cablevision into a satellite-TV company, and take the number from one to two again.

According to Cablevision's version of this plan, which it leaked this week, EchoStar and Hughes would go to amazing lengths to help their new competitor, willingly handing over satellites, distribution and management expertise. Securing finance for the new venture, to be called Rainbow Direct Broadcast, might be a problem: like other cable-TV firms, Cablevision lugs around terrifying amounts of debt. But, notes Ford Cavallari of Adventis, a consultancy, Cablevision does have peripheral assets that it could sell for cash.

Although the Cablevision start-up would be competing against a company starting with nearly 100% of the satellite-TV business, it would have several advantages over the merged EchoStar, says Harold Furchtgott-Roth, a former FCC commissioner who has been helping Cablevision with its plans. As a new company, it could introduce the latest satellite technologies immediately, including smaller dishes, smarter set-top boxes, and new services, such as high-definition TV. EchoStar's and DirecTV's customers are stuck, for now, with old equipment. Also, says Mr Furchtgott-Roth, it would take years for the benefits of the EchoStar merger to show up, as the two companies gradually replaced two sorts of set-top boxes with one.

On the face of it, the idea went some way towards satisfying Mr Powell's concerns. But the FCC's language and its ruling were notably harsh. Mr Powell even pushed the bizarre argument that cable and satellite TV belong to entirely different markets, which is hard to square with reality—or the way the FCC has looked at things in the past. Now it seems that the Justice Department may have decided to play it safe and toe the FCC line.

Rightly or wrongly, people spot more at work at the FCC than antitrust economics. One charge that Mr Powell faces from his critics is that he is a bit of a ditherer. Perhaps he feels the need to act tough on something. A darker explanation points to the hidden hand of Rupert Murdoch, a seasoned Washington campaigner who lost out to Mr Ergen when Hughes's main shareholder, General Motors, put it on the block last year. As Mr Ergen has tussled with the regulators, Mr Murdoch's News Corporation has been quietly husbanding its cash. Failure for Mr Ergen leaves Mr Murdoch holding all the cards.

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European telecoms

The French exception

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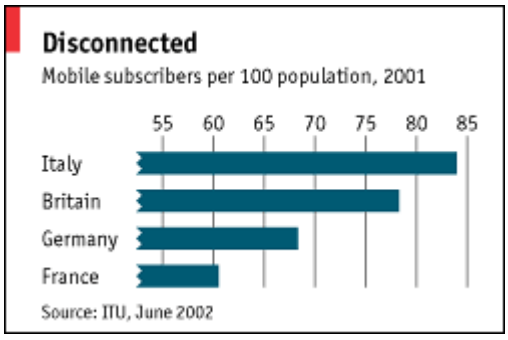
Cegetel and the backwardness of France's mobile-phone industry

DIVORCE battles can be extremely acrimonious, particularly when it comes to custody of children. The tussle between Vodafone, the world's largest mobile-phone operator, and its erstwhile partner Vivendi Universal, a troubled French conglomerate, is no exception. The two firms are fighting over Cegetel, France's second-largest telecoms firm, in which British Telecom (BT) and SBC, an American regional operator, also have stakes. Vodafone has offered to buy out BT and SBC for a total of *euro*6.3 billion ($6.1 billion), which would give it control of Cegetel and its mobile-phone subsidiary, SFR. Vodafone has also offered to buy Vivendi's 44% stake for a further *euro*6.8 billion, an offer that was rejected this week. Cash-strapped Vivendi, with *euro*19 billion in debt, seems to want to hold on to Cegetel at all costs. Why?

For Vodafone, control of Cegetel (and thus of SFR) would be a valuable prize. Over the 1990s, Vodafone's empire-building chief executive, Sir Christopher Gent, established his company as the main competitor to the mobile operations of Europe's incumbent telecoms firms. He did this with the help of local backers, most of which later sold out, leaving Vodafone in control of an impressive international network. Except, that is, in France, which is now the largest and most obvious hole in Vodafone's coverage “footprint”.

Vodafone's partnership with Vivendi, which has since fallen apart, and the involvement of BT, a competitor in Britain, meant that Vodafone did not take the hands-on approach at SFR that it took in other countries. Partly as a result, France fell behind other European countries in the adoption of mobile phones (see chart). With no vigorous competitor for France Telecom's mobile-phone arm, Orange, the market ended up “grossly underdeveloped”, says Stephen Pentland of Spectrum, a consultancy. But France's backwardness now represents an opportunity. As the market reaches saturation across Europe, there is room for growth in France: hence Vodafone's wish to control SFR.



Vivendi, however, is reluctant to cede control of Cegetel, SFR's parent company. Cegetel is a cash cow, unlike the rest of Vivendi's empire, so it makes some sense to hold on to it. But doing so would mean selling other assets and taking on even more debt. Yielding to Vodafone, on the other hand, would let Vivendi pay down some debt. But it would also destroy the central plank of its strategy, which was based on the convergence of media, entertainment and telecoms. (That idea, along with its champion, Vivendi's former chairman, Jean-Marie Messier, has already been largely discredited; ominously, French prosecutors this week launched an inquiry into the accuracy of Vivendi's financial statements during his tenure.) As it restructures, it is not clear which bits of Vivendi will stay, and which will go. Thus, says Damien Chew, an analyst at ING Barings, it is too soon to tell if Vivendi really wants to keep Cegetel, or simply hopes to get Vodafone to make a better offer.

But there is also a conspiracy theory doing the rounds. If Vodafone gains control of Cegetel, the company with the most to lose is France Telecom. Its Orange subsidiary would suddenly face real competition on its home turf, in the form of an invigorated SFR. Orange is one of the key props supporting France Telecom as it tries to reduce its own *euro*70 billion debt pile. If Vodafone gained control of Cegetel, it would be bad news for French bankers, portfolio managers, and the government, which owns 56% of France Telecom. Keeping Cegetel in French hands, in short, may be more than a matter of national pride: it could be a patriotic duty.

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Canon

Hard to copy

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Amid so much gloom, one Japanese electronics firm is thriving

HOW does Canon do it? A dismal home market and sliding exports cripple other Japanese electronics firms, but Canon still makes money as if it were spooling cash out of its high-speed copiers. On October 29th, the camera and office-equipment firm reported a 53% jump in profits in the third quarter. It now expects to earn ¥175 billion ($1.43 billion) for the full year. That would deliver the firm's third straight year of record profits, and maintain an 11-12% return on equity that puts most Japanese companies to shame.

An 81% jump in digital-camera sales helped. But these account for less than 10% of total sales. Much of Canon's consistent profitability stems instead from two other factors. It has held its own in high-margin businesses, by sticking with the traditional Japanese formula for winning technology battles. And it has boosted profits further by relying on more prosaic western business practices to cut costs.

First, the western bits. Fujio Mitarai, president and chief executive since 1995, has tried to apply some of the lessons he learned during the 23 years that he worked for Canon in America. He has narrowed its focus by quitting businesses such as personal computers, typewriters and liquid-crystal displays. He has introduced new methods on the factory floor and better cashflow management. He is also trying gradually to move more manufacturing overseas, the source of 70% of revenues but only 40% of production. He has not, however, embraced American-style job-cutting, retaining a Japanese commitment to his workforce.

But Canon is hardly the only firm to shift from assembly-line to small production cells. Even in Japan, where it is admittedly a leader, it is not the first to try cutting costs. Nor does its improved focus explain how it does so well in the businesses it has kept. Sanyo, another focused electronics firm, reported a 62% drop in net profits on the same day that Canon announced its cheery results. Sanyo's home appliances are being undercut by rivals in China and elsewhere, but Canon's office-equipment continues to maintain high market share and juicy margins.

The rest of the Canon story hinges on technology and how it is used. By ploughing money into R&D (which is now nearly 8% of revenues) and managing its engineers well, it has protected and improved on the core technologies that give it an edge in printers and copiers. This is not just a matter of churning out patents, although Canon is a global leader at doing so. Having broken into the copier business in the 1970s by working around the patents of Xerox, Canon's managers know that R&D and patents alone are not enough. They must be combined with high market share and economies of scale to develop rapidly upgraded products that repel rivals.

Done right, this generates the kind of self-sustaining market leadership that helped Japanese technology firms to terrify American rivals in the 1980s. Mr Mitarai was lucky enough to inherit a firm with this kind of leadership, in a sector with high barriers to entry. His innovation was to stress repeatedly that market share matters only if it generates profits and high returns, and to use cost-cutting to reinforce this approach. Few managers at other Japanese firms have figured this out.

Thus, Canon's core engine technologies still hold nearly 60% of the laser-printer market, including machines sold through an alliance with Hewlett-Packard. Consumables such as high-margin toner cartridges provide a steady flow of cash on the back of this printer business. As Xerox fiddled with financial engineering, Canon continued to invest in new technologies to gain ground in the copier market, with new methods for printing multiple colours and finer, more efficient inks.

True, Mr Mitarai could do better. His company is sitting on nearly $4 billion in cash, which he has vague

plans to spend on acquisitions. That is a better position to occupy than that of most of Japan's indebted electronics giants, but many shareholders would be happier if Mr Mitarai returned more money to them. After profiting from so many American practices, it would be a shame if he failed to grasp this one—and so threw it all away.

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Selling paintings

Art for the masses

Oct 31st 2002
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It may be cheap, but is it any good?

Silk PR

But where did she get that hat?

COMBINING a downmarket concept—the flea market—with an upmarket product—original art—is turning out to be a rather neat business idea. By removing the things that keep most of us out of snobbish galleries in Bond Street or SoHo, such as intimidation, high prices and warm white wine, the Affordable Art Fair (AAF) brings painting, prints and sculptures to the masses. The fair exhibits new work from up-and-coming artists priced at no more than £2,500 ($3,900), with an average of £500.

Started in 1999, the AAF is Britain's largest contemporary art fair. Its most recent show, in London's Battersea last month, was the seventh in three years. It packed in 18,000 visitors, displayed work from 130 galleries and sold £3.3m worth of art, with one in four attendees buying something. Now it is New York's turn: from October 31st to November 3rd, the AAF will hold its first American exhibition, on Manhattan's west side.

The AAF is the brainchild of Will Ramsay, a former officer in the British army and a student of art history, who dislikes the traditional way of selling paintings. “I am trying to do for the art world what Oddbins and Majestic Wine [two British chains] have done for the world of wines,” he says. “Visual art is one of retailing's most backward sectors. Nobody would buy shoes from a shop which sold only one type. Yet art galleries deliberately restrict choice.”

Mr Ramsay's coup was persuading so many galleries to exhibit side-by-side, creating an informal atmosphere in which even an ingénue feels able to ask questions. “Everyone comes in a buying mood,” he says. “They don't feel they have to know about art to own it.”

As director, Mr Ramsay makes three-quarters of his money from charging galleries between £2,000 and £6,000 for their stands and the rest from a hefty entrance fee—£8 in Britain and $10 in New York. With only seven staff and low overheads, Affordable Art makes an impressive 15% operating margin. And the venture is just in its infancy. After New York, Paris is next.

Cheap art may be just the thing for a recession. And it is well-timed to exploit the interior decoration for the masses bandwagon inspired by (pre-ImClone) Martha Stewart in America and, in Britain, by the fad for DIY and the popularity of TV shows that give ordinary people's boring rooms a makeover. Art is the final touch—and these days many people want to hang something original on their walls. Thanks to Mr Ramsay, more of us can dream that it is by the next Picasso.

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RealNetworks

Free thinkers

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Can free source-code stop Microsoft?

FOCUS on what you do best. This age-old strategy has worked well for RealNetworks, Microsoft's main competitor in multimedia software for the Internet. Now, the smaller Seattle-based firm is trying a novel way to contain the software giant. On October 29th, it released the underlying recipe, or source-code, of its RealPlayer software and will soon do the same for its other programs—giving away a big chunk of its intellectual property.

This may sound like a desperate echo of 1998, when Netscape, struggling in Microsoft's chokehold, published the source-code of its web browser (an initiative that yielded few real results until this June, when the first serious new version of the open-source browser, Mozilla, was released). Yet RealNetworks is not playing defence. It is trying to encourage the creation of a common multimedia software infrastructure for every kind of file format and device, thus thwarting Microsoft's ambitions in this promising market.

The firm hopes that others in the industry (volunteer programmers, media firms and hardware makers) will take the code, called Helix DNA, improve it and make it run on new devices, such as mobile phones and home stereos, turning RealNetworks' software into an industry standard. Clever licensing terms are supposed to ensure that this standard does not splinter and that the firm still makes money.

Individual developers, universities and other non-profit organisations can modify the software as they please, and even redistribute it for free, so long as they also publish the source-code for their changes. This is a sort of payment in kind, for RealNetworks is then allowed to use these contributions. Firms, on the other hand, must pay royalty fees if they distribute more than 1m copies of the code. They also have to make sure that their software works with other Helix DNA products.

The software's development community already has 2,000 members. And several hardware makers back the effort. But there are risks. Afraid of piracy, media groups are suspicious of anything that might be related to hackers (although they also do not want to depend on, and pay for, technology controlled by Microsoft). The self-created competition could also hurt RealNetworks if customers decide its commercial products, which will be based on the open source-code but with extra features, are not worth paying extra for.

RealNetworks' move is another sign that the software industry is going hybrid. Mixing elements of proprietary software, where the source-code is tightly controlled, with open-source programs enables firms to expand a market, harvest the ideas of others and, they hope, still make money. Even Microsoft is edging this way: it recently announced that partners can now look at—but not modify or re-use—the source-code for Passport, its controversial digital-identity service.

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Brand wars in the Middle East

Regime change

Oct 31st 2002
From The Economist print edition

Arab shoppers are abandoning western brands for local alternatives

IT IS no joke. The self-appointed Egyptian Committee for Boycott wants consumers to stop buying Procter & Gamble's Ariel soap powder because, they say, it is named after Israel's prime minister, Ariel Sharon. The activists argue that Ariel's logo is really a star of David. “It's ridiculous”, says P&G. “Ariel was around long before the Israeli leader. Our logo represents an atom's path, not a religion.” Yet sales of Ariel in Egypt are suffering. Across the Middle East, America's war on terror and its threats to Iraq have inspired consumers to boycott American brands from Pampers nappies to Heinz ketchup.

PepsiCo blames the boycott for flattening its non-American drink sales. Coca-Cola says the consumer strike has hit business in Bahrain, Lebanon and Saudi Arabia and lopped up to 10% off its sales in the region. Fast-food outlets in Saudi Arabia, such as KFC and Burger King, report a 50% drop in sales since September 2000. Losses have led McDonald's to close two of its six restaurants in Jordan; its outlets, as well as the rival Burger King's, have been attacked in Lebanon, Oman, Bahrain, Cairo and Qatar. Supermarkets in Bahrain and Egypt are pulling American brands from their shelves and refusing to stock Nike shoes.

Lest Europeans succumb to the usual *Schadenfreude*, this campaign is as much anti-western as anti-American. Shoppers are shying away from big European brands such as L'Oréal cosmetics and Nestlé, and protesters recently gathered outside Mercedes dealerships in Amman, Jordan. In the past year overall business at western fast-food and drinks firms has dropped by 40% in Arab countries. Trade in American branded goods has shrunk by a quarter.

This is not so much a rejection of western capitalist culture as of its products, for Arab consumers still have a taste for brands, so long as they are local. Iran's “Islamic” Zam Zam Cola, named after a holy spring in Mecca, is now the real thing for many a Middle Easterner. Hardly able to meet domestic demand, Zam Zam, once PepsiCo's Iranian partner, has exported 10m bottles in just four months to supermarkets in Iraq, Bahrain, Qatar and Saudi Arabia, where it will tempt 2m thirsty Muslim pilgrims bound for Mecca next year. Sweeter than Coke, the fizz is now being launched in Europe, targeting the Muslim diaspora. A Muslim entrepreneur plans to sell Mecca Cola in France (Palestinian charities will share the profits).

Sales of Star Cola, made in the West Bank, have risen by 40% in the past three months in the United Arab Emirates. The Cairo-based Al Ahram Beverages, recently bought (quietly) by Heineken of the Netherlands, has become one of the world's most profitable breweries by selling beer to Muslims (alcoholic varieties are discreetly home-delivered). Egyptian souks are even peddling Yasser Arafat crisps.

Although consumers may gain greater satisfaction from a spiritually correct brand, the boycott will have significant costs for Arab economies. Most western multinationals make a small fraction of their total sales in the Middle East, but they are often the biggest and best employers there, setting an example for local firms and providing management experience for talented Arabs. Coca-Cola, for example, employs 20,000 people directly in the region, and 200,000 including retail and supply jobs. That dwarfs even big local rivals such as Zam Zam, which has 8,000 staff, or Al Ahram, with 4,000.

How western are these foreign brands? Arabs run and supply McDonald's franchises in the region. Coca-Cola typically operates with Arab partners, such as the Olayan family in Saudi Arabia and Abdul Hak in Yemen and Egypt. It pays workers 15% more than home-grown firms. In Lebanon, the 440 staff at Coke's main factory are locals. In Palestine, Coke, with a local bottler, National Beverage Company (NBC), ferries workers past checkpoints to their villages, offers loans, accredited training and health

plans, and exposes staff to new business ideas.

Zahi Khouri, chairman of NBC, 15% owned by Coca-Cola, says locals lose by boycotting western firms. “I've yet to meet an American running any of Coke's Arab operations. I can't see why a Palestinian shouldn't run Coca-Cola one day, if he is good enough.” He sympathises with Muslims who rage that American policies favour Israel, but says western business is not to blame. “I don't equate US administration policies with those of US corporations. The more the world is exposed to multinationals the better. They fuel competition, set standards and teach us about discipline, commitment and service.”

Ahmed Zayat, boss of Al Ahram, fought in Egypt's supreme court for the right to offer his staff share options. “Arabs must learn the best practices and creativity of western firms, not drive them away. If we want to be global, we need their muscle.”

In Egypt, P&G has spent $97m on factories and also community projects—building schools, financing health education and even paying for Muslims to go to Mecca. Coca-Cola is the second-biggest investor in Lebanon and Palestine. Steven Leroy, Middle East spokesman for Coca-Cola, says the group is delaying hirings and investments because boycotts have dented confidence. That is unfortunate in a region that, with 20% average unemployment, needs every job it can get.

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Face value

Cleaning up the boardroom

Oct 31st 2002
From The Economist print edition

America has Sarbanes-Oxley. Britain has Derek Higgs

EXCEPT that he is a devoted reader of the left-leaning *Guardian* newspaper, Derek Higgs is a typical member of the City of London elite. An astute deal-maker at the Warburg investment bank, an engaging dinner companion and comfortably rich, he also possesses an essential piece of banking equipment: a safe pair of hands. The sort of chap that British governments down the years have got to run committees to defuse political bombs with some sensible proposals, he is concluding a review of corporate governance ordered after some spectacular business failures at home (Marconi) and abroad (Enron). His report is likely to advise little more than a fine-tuning of present practice in British boardrooms. If, as has been suggested this week, ministers are worried that he “has not come up with anything radical enough”, the surprise is that they expected anything else.

Compare and contrast Mr Higgs's gentle tweaks with the American response to Enron and other disasters: a hefty piece of legislation known as Sarbanes-Oxley—and sometimes SOX—that is named after the two congressmen who sponsored it. Although it has many excellent parts—notably, tougher regulation of auditors and restrictions on what non-audit work they may do—the rest of Sarbanes-Oxley is more of a hotch-potch that risks benefiting mainly the lawyers.

Few are inclined to give a sympathetic hearing these days to company bosses, whether in America or anywhere else. If they were, they would hear a litany of complaints about over-reaction by legislators, prosecutors and regulators rushing to be seen to act tough. The result, they fear, will be boardrooms paralysed by red tape and non-executive (outside) directors turned wholly risk-averse by legal advice on how to avoid being sued into poverty should their firm ever fail. That assumes people can be found who are even willing to become non-executives. There is now no quicker way for an American boss to empty the 19th hole at his local golf club than to ask: “Would anyone like to serve on my board?”

In Britain, too, there are signs of a growing reluctance to become a non-executive, given the extra scrutiny and workload involved, and the likelihood of being blamed, deservedly or not. Although Mr Higgs is likely to echo Sarbanes-Oxley by recommending that non-executives should be truly independent from executives, he is unlikely to be overly rigid in his definition of independence and is expected also to make proposals to calm some of the worst fears of potential recruits—such as that clear limits should be set for their personal liability.

You say tomato

Just as Americans and Britons are divided by a common language, so their firms are divided by a common board structure. Superficially, both countries have similar “unitary” boards, made up of a combination of executive and non-executive members. This is in contrast to the two-tier boards of German companies, which have an executive management board overseen by a non-executive supervisory board. Yet in practice British and American unitary boards are quite different creatures; and they are likely to move even further apart, thanks to the efforts of Messrs Sarbanes, Oxley and Higgs.

In theory, members of a unitary board combine two tasks: developing the firm's strategy, in the broadest sense, and ensuring compliance with the law and best practice. What actually happens is often quite different. Until the 1990s, boards in both countries were dominated by the executives. Non-executives

were largely compliant cheerleaders.

In America over the past decade, the dominance of the chief executive (usually the only executive on the board) has increased, with non-executives providing huge pay and share-option packages as well as their cheers. Not so in Britain. Non-executives often remained a minority on their board, but their ability to act as a check and balance on the chief executive increased significantly, thanks to proposals in a series of reports written by knighted worthies—three company bosses (Sir Adrian Cadbury, Sir Richard Greenbury, Sir Ronald Hampel) and a fund manager (Sir Paul Myners). The big difference has been the creation of a dual corporate leadership, by a part-time non-executive chairman of the board and a full-time chief executive. In America, the chief executive is typically also the chairman, allowing him to rule the boardroom roost unchallenged.

The British reforms came largely through voluntary codes and self-regulation, rather than legislation. That allows a degree of pragmatism, favouring effectiveness over enforced compliance with a governance law. (Mr Higgs, a fan of the separation of chairman and chief executive, proudly sits on the board of British Land, where John Ritblat holds both jobs.)

Sarbanes-Oxley may, in contrast, allow too little discretion. Its independence rules, strictly interpreted, could lead to non-executives with no business experience being hired after a box-ticking search process, instead of talented and independent-minded business people. The new legal burdens of non-executives, particularly on audit committees, may mean that the atmosphere in American boardrooms swings too far, from excessive adulation of the chief executive to its opposite, curbing the risk-taking that is essential to corporate success.

British corporate governance is not as marvellous as many Brits smugly believe. To dismiss Marconi's collapse as a failure of business judgment but not of governance smacks of complacency, and raises fundamental questions about what good governance actually means. And Mr Higgs could usefully propose ways to make institutional shareholders take a closer interest in the firms they own, though he seems unlikely to do so. Even so, British companies may well be grateful that Mr Higgs has followed the hallowed advice of “first, do no harm”.

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Japanese economy

The ghost of reforms past

Oct 31st 2002 | TOKYO
From The Economist print edition

Japan's occasional attempts at economic reform are a gruesome sight. This week's is no exception

Get article background

FOR over a decade, Japan's distressed economy has stumbled from one brief upturn to another. After taking over as prime minister in April 2001, Junichiro Koizumi inspired hope that the stumbling would stop. The tough-talking politician promised that he would be firm with drowning banks and bloated public corporations. Painful structural reforms are the only sensible way to restore strong and lasting growth, he proclaimed. And then he stalled for 18 months.

Recently, however, he had rekindled hopes that Japan was finally about to tackle its problems head on. Then this week he dashed them again, with what could be his most dangerous disappointment to date. On October 30th, Mr Koizumi and Heizo Takenaka, his minister for economic and fiscal policy, celebrated Halloween a day early by wrapping yet another flimsy financial package in a costume that they labelled “reform”.

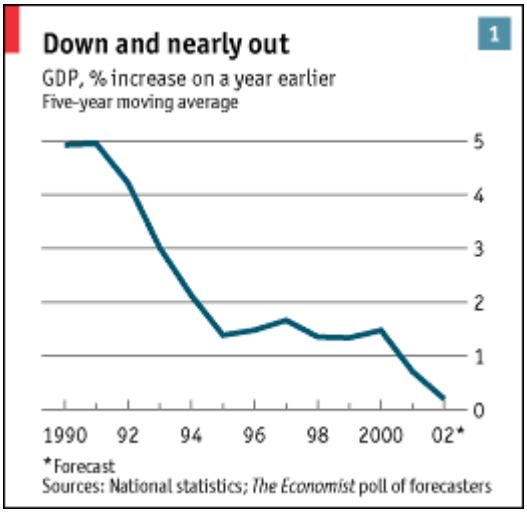
Something far more substantial had been expected. Only a month earlier, the prime minister had reaffirmed that his government would resolve the banks' big bad-debt problem—which lies at the heart of the economy's woes—by early 2005. And he put Mr Takenaka, an academic, at the head of the Financial Services Agency (which regulates the banks). He seemed a promising choice to replace Hakuo Yanagisawa, who had done little but drag his feet as the nation's top bank regulator.

Hope deferred

As often as they have been disappointed by Japan's inability to keep its promises, onlookers nevertheless find it hard to ignore such loud talk of reform in what is still the world's second-biggest economy, and one of America's most important allies. North Korea's recent admission that it is toying with nuclear weapons serves as a reminder that Japan is still a crucial ally in volatile East Asia.

With deflation looming over Germany and the United States, there was even wider interest than usual in this particular

promise of economic reform. This was partly because Japan's past mistakes could hold lessons for policymakers in deflationary environments elsewhere. But it was also because what was flagged as the best chance of Japanese reform in years raised hopes that it might counter persistent weakness in the world's other big economies, as well as in Japan itself.



Hope faded, however, as Mr Takenaka was seen to be running into fierce opposition from the bankers, bureaucrats and politicians who invariably conspire to resist reform in Japan. Last week, politicians in Mr Koizumi's Liberal Democratic Party consigned Mr Takenaka's initial bad-debt plan to the cemetery, before he even had a chance to announce it. Disappointment pushed down the value of the yen against the dollar to a four-month low.

Not only was his plan unfair to Japan's bankers, argued the politicians, but it would bury the zombie companies (in such sectors as retailing and construction) that continue to haunt both the banks' balance sheets and their healthy competitors. It is these companies that bankroll the conservative politicians who sit at the heart of Mr Koizumi's party.

Since laying some of the zombies to rest is one of the main points of reform, this was a worrying reversal. Mr Koizumi's response was to do his best impersonation of a ghost. For a full week his leadership was all but absent as Mr Takenaka was left to fend for himself. It was not surprising, therefore, that on October 30th the new bank regulator released a mere skeleton of his original ideas.

Mr Koizumi insisted that his plan to solve the bad-debt problem was still on track. “We will use various methods so that companies can focus on their business and the public can live comfortably during the two-and-a-half years while the non-performing loan problem is resolved,” he said, sounding much like a man trying to avoid inflicting any pain.

Although the plan contained the usual platitudes about changing the way in which banks evaluate the quality of their loan portfolios, Mr Takenaka surrendered on the main issue that was intended to give him leverage over the banks. Instead of relying heavily on bankers and bureaucrats to evaluate the loans, he had planned to move more quickly and authoritatively by tinkering with the other side of the banks' balance sheets.

The idea was to change the rules by which banks calculate their capital—in particular, by limiting the amount of deferred tax that they can use for the purpose. If Mr Takenaka had succeeded in this, he might have been able to force under-capitalised banks to accept the more substantial changes that really matter.

Of these, there are two, and debate rages over which is the more important. One is the cleaning up of the banks themselves. This means removing loans that will never be repaid from their balance sheets, injecting enough public money to allow those that stay in business to emerge in good health, and, ideally, ensuring that executives at the most mismanaged banks are replaced with people who know something about modern business. The other requirement of reform is that the weakest companies to which the banks have lent money—the zombies—be restructured, rehabilitated or put out of their misery.

The land of the loophole

There was, in fact, some genuine cause for concern about Mr Takenaka's deferred-tax plan, not least that it risked penalising the few banks that have actually tried to clean up their mess. The minister's new plan, however, and the way in which he was bullied into it, leaves him and other would-be reformers with little hope that the current Japanese prime minister can carry their cause.

This grim conclusion makes it hard to get excited about the long list of other economic measures that were unveiled in the middle of the week. These included a fresh move by the central bank to loosen monetary policy a little further; some new ideas for taxes and spending; and the announcement that a new entity will be set up to help rehabilitate some borrowers once their loans have been taken off the banks' books.

Kathy Matsui, the chief equity strategist at Goldman Sachs, had warned that the question would be whether government “policy is used as a narcotic to hide the underlying disease” or “as anaesthesia to ease the pain of radical surgery”. This week there was no sign of a scalpel.

The basic concern about the package is that it will not lead to much fiscal expansion; it will probably not prod the Bank of Japan into a sufficiently bold monetary stimulus; it will not take the pressure off well-run companies; and it will not repair the broken banks. “This kind of vaguely worded, lots of loopholes, watered-down programme is not much help,” said Takahira Ogawa, the director of Asian sovereign ratings at Standard & Poor's, a credit-rating agency.

Taking the problems with the package in reverse: Mr Takenaka's proposal to write off the banks' bad loans now relies on timetables and promises which the bankers and bureaucrats must follow—a proven Japanese formula for doing nothing. The government has already delayed plans to roll back deposit insurance, which were intended to come into effect next April as a way to impose market discipline on the banks' deposit-taking. So there is little reason to count on the delayed action that the government is now promising.

As the past month of debate makes plain, there will be no support for dealing with bad loans when the economy is weak, which it is likely to remain for at least as long as the bad-loan problem is unresolved. Moreover, at no time is it ever permissible for a Japanese minister to suggest that this is the bankers' or the politicians' fault. Any solution to the banks' problems, therefore, must somehow be arrived at without reference to reality.

This go-slow approach may not, however, be the worst news to have emerged this week. The government's plans, still vague, to set up a new entity for rehabilitating troubled borrowers give considerable cause for alarm. The effect will be to ensure that, even as a trickle of bad loans are being written off by the banks, officials will be looking for ways to put fresh public money into companies that they deem worthy of propping up.

There would be a case for giving limited credit to some firms if the government were indeed going to prod banks into rapid loan write-offs. This would be a way to cushion the blow on the economy of a severe shock to the financial system, and it could potentially lead to a more orderly closure of small firms.

But since it is now unlikely that there will be any fresh loan write-offs, this plan simply provides another lifeline for firms that are already undercutting healthier rivals. In fairness, the government has bailed out plenty of unworthy firms in the past without needing such an entity. In October, for example, it announced yet another attempt to revive Daiei, a troubled retailer that has had more lives than a bewitched cat. So the incremental damage from this new bad idea might be limited.

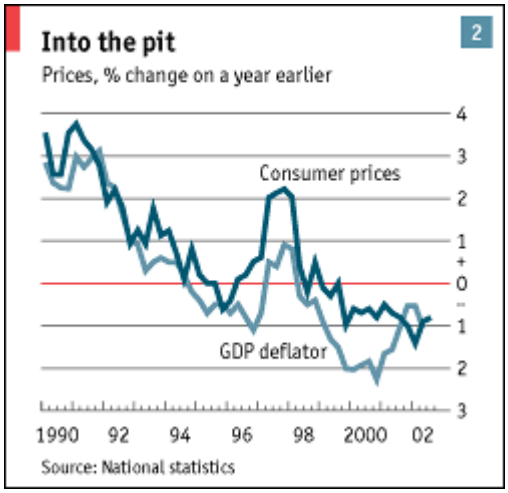
In a deflationary trap

Since bad loans and bad companies will continue to survive, the prospects for bolder monetary policy also grew gloomier this week. That may seem an odd claim, given that the Bank of Japan announced some measures to make money even looser. First, it will increase its purchases of Japanese government bonds by 20%, to ¥1.2 trillion ($9.8 billion) a month. And the central bank will expand its “quantitative easing” by increasing its target for excess liquidity in the banking system by ¥5 trillion, to a range of ¥15 trillion-20 trillion.

The trouble with these moves is that, in Japan's current predicament, such narrow approaches to combating deflation do little good. Because the Bank of Japan was consistently behind the curve in easing monetary policy, the economy was already mired in a deflationary bog by the time interest rates hit zero. Consumer prices have been falling on an annual basis for three years now (see chart 2). Despite low inflation rates elsewhere, Japan is still the only rich economy where prices are actually falling.

The only hope for reversing this would be for the country's central bank to announce a bold new initiative, with a specified inflation target to get prices rising and a willingness to buy whatever assets were necessary—from property to bonds to equity funds—in order

to achieve it.



Bank of Japan officials have always resisted such ideas. But when Mr Takenaka was put in charge of bank regulation, they began putting out clear signals of their willingness to do a deal. In September, the Bank of Japan announced that it would buy ¥2 trillion-worth of shares from the banks' equity portfolios—not enough in itself to make much difference, but a symbolically important step. Now that Messrs Koizumi and Takenaka have failed to deliver, the bank may continue to announce looser money, but it is unlikely to take the more radical steps that Japan needs.

Finally, with the Bank of Japan sticking to traditional monetary tools, with weak banks preventing those tools from doing any good, and with zombie companies still floundering about, any fiscal stimulus that Japan tries will have little effect—especially given the tired old tax-cut measures announced this week.

Japan has spent lavishly on public works throughout the past decade, which has helped its gross public debt to reach 140% of GDP. Jesper Koll, chief economist for Merrill Lynch in Tokyo, reckons that the government would have to cut spending and raise taxes by a combined 8% of GDP every year just to stabilise its finances.

The tendency to blanket the countryside with roads, dams and bridges is often cited as one of the main indictments of Japan's political system. Whether spending on more productive items would have made a difference is debatable; but the government has to some extent undermined its own spending efforts through ill-considered changes in tax policy. A decent recovery was under way in the late 1990s, for example. But it was snuffed out at least partly by a poorly-timed rise in consumption tax.

It is true that matters might have been worse without some of this spending, and that a determined fiscal push would indeed be a part of any sensible reform package. Nevertheless, if Japan does not deal with its monetary, financial and structural problems first, it is hard to imagine any fiscal push breaking the economy free of its deflationary trap. In a nutshell, argues Richard Jerram, chief economist at ING Barings in Tokyo, this week's package is “unlikely to end deflation”.

Where next?

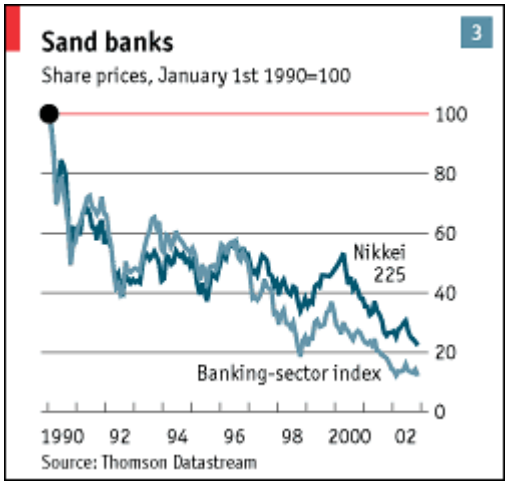
So what happens now to Japan's economy? Even if Messrs Koizumi and Takenaka had been tougher, genuine reform was always going to be a difficult fight. Japan's economic problems have grown progressively bigger and harder to solve through years of inaction. And two of the most worrying components of the slump—falling prices and zero interest rates—have the nasty political side-effect of making it easy, in the short term, to ignore the severity of the problem, even as they conspire to make it worse.

Most Japanese households have, in reality, grown steadily worse off during the past decade. Government debts have mounted (increasing future taxes) and they have earned pitiful returns on their savings. Falling prices throughout the economy have, however, softened the impact of the long slump on their standards of living.

Moreover, with interest rates close to zero, even the most irredeemably indebted companies have been able to continue making payments on their loans, scraping the money together by cutting their workforces and forgoing investments. Those weak companies, in turn, undermine revenues at stronger companies and push more of them to the wall. Deflationary pressure also discourages healthier firms from investing, so few of them wish to borrow even at near-zero interest rates. With no strong borrowers to lend to, the banks find it even harder to earn profits with which to write off their bad loans.

To some extent, therefore, Japan's economy is trapped, as the

symptoms of its long slide have become self-reinforcing. Unlike countries such as neighbouring South Korea, which responded to its crisis five years ago by promptly cleaning up its banks, Japan's massive trade surpluses and domestic savings allow it to continue to postpone action, even as it stores up trouble for the future.



While onlookers in other wealthy countries ponder the prospect of deflation, it becomes clear that this sort of slow, inexorable slide is worth avoiding at almost any cost. Even if deflationary pressures elsewhere mount, however, Japan's twisted politics offer some comfort that America's and Europe's different ways of doing things can avert such a fate.

As this week's disappointment makes plain, Japan's policymakers are caught in a trap that is every bit as vicious as the economic one that has gripped the country. Although politicians in the Liberal Democratic Party are eager to spend money, tight and ineffective monetary policy has kept the fiscal stimulus from doing much good.

Monetary policy, in turn, does not work as well as it should because the bad-debt mess makes banks hesitant to extend fresh loans. Yet efforts to clean up those bad debts are then thwarted by politicians in the LDP, men who would love to re-inflate the economy but who do not want to put weak borrowers out of business. And rather than pressing plans to solve the impasse, Japan's bureaucrats try to spin it to their advantage, so that they can gain an edge over rival ministries.

When confronted with this dismal display, the politicians, bureaucrats and bankers all blame each other, and bystanders blame the lot of them. The only realistic way to change this is for someone in Japan to exercise some real leadership and get all of these groups working together. That is why Mr Koizumi's election 18 months ago, and the recent signs that he was reasserting himself, inspired such widespread hope.

For, despite the size of the problem, and the failure of isolated policies to reverse it, there is every reason to believe that a concerted effort involving co-ordinated policies could turn things around for Japan. Mr Koizumi has had a golden opportunity to do this during the past month. The Bank of Japan got things rolling by signalling its willingness to consider new ideas for monetary policy. After handing Mr Takenaka control of bank regulation, it became clear that he faced a simple “either-or” choice. Take the bad loans seriously, or ignore them.

In the end, despite a recent rebound in his popularity and some success for his party in by-elections held on October 27th, Mr Koizumi chose to revive the same half-measures that have persistently failed to help Japan's economy regain its high potential. It was a curious way to greet Halloween. The man who has spent the last 18 months disguised as a courageous leader finally took off his mask.

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Policing accountants

The Pitt and Webster show

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AP

A brand new bureaucracy is born under a bad sign

WITHIN six months a new body to oversee auditors, the Public Company Accounting Oversight Board, will be up and running, with advantages its cash-strapped parent, the Securities and Exchange Commission (SEC), can only envy. The board's five directors will earn somewhere near three times more than an SEC commissioner. Its expected annual budget of $100m will be about one-fifth of what the SEC gets for doing a very much bigger job. And, rather than having to extract its allowance from a reluctant Congress, it will get the money from a compulsory charge on the accounting industry. Despite these advantages, not all augurs well for the new board. Its messy birth was attended by sharp political battles and conflicting arguments about its role.

The mess was on view on October 25th when the SEC met, according to its chairman, Harvey Pitt, “to consider potential candidates” for directors of the new board. As it happened, the consideration was kept to a minimum, for Mr Pitt and the two other Republican commissioners forced through the appointment of William Webster as chairman. Mr Webster is a noted former federal judge, the only person to have run both the CIA and the FBI, and an arch Washington insider. It would be a stretch to say that he is intimate with the niceties of corporate accounting.

After the vote, the SEC's two Democratic commissioners, Harvey Goldschmid and Roel Campos, said that if Mr Pitt was not actually under the thumb of the accounting industry, he certainly gave the impression of being so, bringing discredit not only to the SEC but to the new board as well. This provoked an emotional rebuttal from Mr Pitt. For good measure, Mr Pitt and his colleagues then appeared to accuse each other of lying about whether the chairman's job had earlier been promised to another candidate, John Biggs, until recently the chairman of TIAA-CREF, a large pension fund for teachers.

Such a spat is unprecedented at the SEC. It has caused despondency within the commission and on Wall Street. Now it appears that Mr Pitt did not tell his fellow commissioners that Mr Webster had until recently headed the audit committee of a firm facing accusations of fraud.

Mr Pitt could surely have handled the appointment process in defter fashion. More than 450 candidates had, over a couple of months, been considered for the new oversight board. An appointment to the board carried two chief attractions: the challenge of cleaning up an essential but sullied part of the plumbing of capital markets, and a salary that is unlimited by federal caps (nominally, the board is private). Potential directors were told that four positions would pay $400,000 a year, the same salary as the American president, while the chairman would get $500,000. Surely a chairman acceptable to all could have been found and quietly vetted without a nasty fight? Even Mr Webster might have been installed without

bitterness, had his name been floated at the start of the process rather than at the end.

Instead, in early September Mr Pitt and Mr Goldschmid visited Mr Biggs and—according to Mr Goldschmid, but not Mr Pitt—offered him the job. Certainly qualified, Mr Biggs had firm ideas about how to straighten out American's accounting industry. They were ideas drawn not just from running an investing institution, but also from his time on an earlier, weaker accounting oversight board that was laid low by the industry. Although no criticism was openly voiced against Mr Biggs, his candidacy suddenly faltered. The impression is of discreet but vigorous lobbying by an accounting industry with much to lose.

So Mr Webster it is. It may be that an outsider is just what is needed to shake up auditors, demanding greater independence and higher standards. Certainly, Mr Webster is a man of tough integrity and a quick study. Yet Mr Campos, the second Democratic commissioner, says that Mr Webster's background may fall short of the industry-specific knowledge of securities laws and auditing that is required under the Sarbanes-Oxley act, the legislation that fathered the oversight board. As a consequence, Mr Campos says, the board faces a risk of legal challenge.

Philosophically, the biggest task for the new board may be defining what the point of auditing is, says Donald Langevoort, a professor at Georgetown Law School. The narrow perspective is that the audit is no more than a contractual agreement between a company and its auditor, with standards subject to negotiation. A view closer to the mainstream is that, for the public good, standards must be uniform among all companies; and that these standards should be made far stricter than they have been. The split over the new chairman appears to reflect a deeper dispute over how far reforms should go.

The split over the new chairman appears to reflect a deeper dispute over how far reforms should go

A rocky start for a regulatory agency is nothing new. When the SEC was established in 1934, it was widely expected that the first chairman would be James Landis, a feared and brilliant lawyer with an essential knowledge of administrative law. In fact, facing a backlash from business, President Franklin Roosevelt named Joseph Kennedy, a trader of the most roguish sort. The appointment was met with dismay by those hoping for reform. Yet Kennedy did the agency good, not least by getting decent funding for it.

Landis succeeded Kennedy, but it was the commission's third chairman, William Douglas, who is seen as the most effective early leader, in large part because of his expertise in bankruptcy law, much in need during the Depression years. Mr Webster will do well if he gets the oversight board up and running smoothly. Without accounting expertise, on the other hand, more profound change may have to await a successor.

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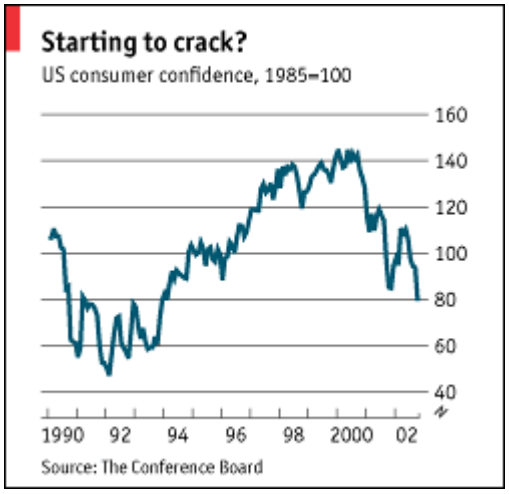
Consumer confidence

Bleak households

Oct 31st 2002
From The Economist print edition

American interest rates, at their lowest for 40 years, are heading lower



THE odds have risen of America's Federal Reserve cutting interest rates at its next meeting on November 6th. Although new figures this week showed that GDP growth remained robust in the third quarter, the economy may now be shrinking—or be just about to.

The most striking news is the plunge in the Conference Board's index of consumer confidence, from 93.7 in September to a nine-year low of 79.4 in October. This drop, the fifth consecutive month of decline, was much bigger than expected. Consumers seem to have been rattled by lower share prices and deteriorating job prospects. Consumer confidence is no perfect predictor of spending, but the size of the decline since May has only ever before been experienced during or just before a recession.

Over the past year, consumer spending has supported the American—indeed the world—economy virtually single-handed. If consumers now decide to sit on their wallets, while business investment remains depressed, another recession looks hard to avoid.

Until now, consumer spending has been propped up by tax cuts, and by a combination of falling interest rates and rising house prices that have encouraged borrowing. This has allowed households to put off any belt-tightening, even as their equity wealth has shrunk. Mortgage-equity withdrawal has been running at a record rate, and much of the money was used to buy cars and other consumer goods. Now consumers may be starting to wake up to the fact that equity holdings are worth about $7 trillion less than they were in 2000. Lower wealth and lower expected future returns on assets mean that households need to save more and spend less.

Since the Fed met in September, retail sales, manufacturing output and durable-goods orders have all fallen. Most economists now expect rates to be cut next week. Some are tipping a half-point cut. The deciding factor may be October's job figures, due on November 1st.

The Fed faces a dilemma. Households are already up to their neck in debts, and another rate cut might encourage them to borrow even more. This, say some, is simply postponing the day of reckoning. Then again, if consumers reduce their spending, another recession when inflation is already low could risk deflation—a dangerous notion when mixed with lots of debt. Japan's experience suggests that the Fed should do everything it can to avoid that.

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Shareholder activism

Will the owners please stand up?

Oct 31st 2002
From The Economist print edition

Institutional investors pledge to act against company delinquents

BACK when the shares of Tyco International, a conglomerate that is now bust, were still rising in 1998, shareholders proposed that the company alter its board to make a majority of its members independent. The resolution was defeated, partly because Fidelity Investments, America's biggest mutual-fund manager, voted against it. More independent directors might not have saved Tyco, which according to prosecutors was run like a criminal enterprise. All the same, it is clear that many institutional investors voted unthinkingly with management when share prices were soaring in the 1990s. Now, after so many scandals, some managers admit that, as owners of shares on behalf of individual savers, they should have done more to curb corporate excesses.

Many institutions now promise to work more actively on corporate governance. In America, those responsible for 14 state pension funds, together managing over $1 trillion of public pension money, have said they will actively seek to clean up corporate corruption. Jack Bogle, founder of the Vanguard group of mutual funds, is leading other investors in a crackdown on executive pay. Germany's second-biggest mutual-fund manager, Deka Group, is thinking of becoming more activist. In Britain, the Institutional Shareholders Committee, which represents the country's pension funds, insurers, fund managers and unit trusts (mutual funds), has announced a new activist code.

That is welcome news: institutional investors, especially if they band together, have the clout to demand change at companies whose shares they hold. Shareholders ought to leave the day-to-day running of a company to its managers, but they should be ready to interfere in cases when executives undermine corporate governance—changing an accounting policy purely to inflate profits, for instance.

Until now, big investors have shown surprisingly little inclination to criticise companies or to vote against management at shareholder meetings. Although a few, such as CalPERS, the California Public Employees' Retirement System, and Hermes, a British fund, speak out, most institutions prefer to vote with management; they make their complaints behind closed doors, if at all. Often, institutions intervene only when it is too late. In Britain, little more than half of the shares in the biggest 350 companies are voted. Votes against management are rare. Voting levels are higher in America, at about 80%; yet even there, strongly backed resolutions are routinely ignored, for they are not binding.

Until now, big investors have shown surprisingly little inclination to criticise companies or to vote against management at shareholder meetings

Why have institutions kept quiet? Lambasting company executives in public, they say, may damage share prices. In any case, it is easier simply to sell shares than to influence management. Not only does it cost money to be active, but the benefits of improved corporate governance are spread among all shareholders. Many investment managers pursue so-called momentum strategies—investing in a share mainly because others do—and hold stocks for perhaps less than a year: they have little incentive to improve governance. Even institutions that track indices, and so may not sell shares, have not been particularly activist.

The biggest obstacle to shareholder activism is the fact that most big fund managers also run money on behalf of companies—in the form of 401(k) plans and pension funds. A fund-management firm that owns a stake in a company might also have the mandate to run its pension fund. Should a fund manager vote against, say, a stock-option scheme for executives, they can retaliate by dumping the manager from running the pension fund. “We act on corporate governance, but below the radar screen,” says Alan Brown, chief investment officer at State Street Global Advisors. Otherwise, he says, the firm's commercial interests could suffer.

Asset-management firms that are part of a universal bank are especially at risk from such conflicts of interest. One example was the fight over Hewlett-Packard's merger with Compaq. Carly Fiorina, Hewlett-Packard's chief executive, told Deutsche Asset Management, part of Deutsche Bank, that a vote for the merger was “of great importance to our ongoing relationship”. The fund manager voted in favour, days after Deutsche Bank had signed a $4 billion revolving credit facility for Hewlett-Packard to pay for the merger.

If, for these and other reasons, institutional investors do not become more active in future, regulators will push them. The chairman of the Securities and Exchange Commission (SEC), Harvey Pitt, wants mutual funds to disclose their voting records and policies. That way, investors would be able to discover if their mutual-fund company had voted against their interests. In Britain, the government may force institutional investors to reveal how they vote. Mr Pitt amazed a gathering of investors in September when he said that the SEC would look into scrapping the ordinary-business exception, a rule that bars shareholder resolutions on supposedly everyday matters. Companies ought not to be able to use this rule to stop investors expressing their views on subjects such as stock options and consulting work by auditors, Mr Pitt said.

The best reason for institutions to become more active ought to be their own investment performance. Yet, although a number of studies have suggested that intervention by institutions over matters of corporate governance can boost profits and share prices in the long run, the results are inconclusive, especially when considering the risk of angering customers.

One way to minimise the cost of shareholder activism, says Bernard Black, at Stanford Law School, would be for institutions to put their strength behind initiatives that affect hundreds of companies, not just pick on a few. For instance, at next year's season of annual general meetings, he says, they should get together and push for proper accounting for stock options. That would certainly be a good start.

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Wall Street research

Learning to be angels

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Bankers and regulators ponder virtue

THE interests of the big Wall Street firms and the regulators have begun to converge. Both sides want a settlement, however inane, to the long-running row over investment research. As *The Economist* went to press, lawyers for the ten biggest firms were at the New York Stock Exchange thrashing out a deal with regulators from the Securities and Exchange Commission and officials from the office of New York state's attorney-general, Eliot Spitzer.

The chief idea is a $1 billion, five-year commitment by the firms to fund independent research arms free of conflicts of interest. The idea would no doubt have been approved already were it not for some niggling details. There is, for example, a lack of consensus on the definition of independence, on how much each firm should pay up, on who should be sent the research, on the conditions to be imposed on all other investment banks, on where the money should go, on whether the consequence will merely be a tax on investors, and so on. The whole thing sounds a terrible idea, but what firm dares antagonise regulators by piping up in public?

Most desperate to resolve the legal issues are Citigroup and its chief executive, Sandy Weill. Wall Street's biggest bank has been embarrassed by its relationship with Enron and WorldCom, and by conflicts of interest over its research. On October 30th Mr Weill announced that he had hired Sallie Krawcheck to head a new group that will pool Citigroup's equity research and its 12,500 private-client brokers. The group will remain chastely within its own walls, away from the lascivious attentions of Citi's investment bankers.

Ms Krawcheck had recently been promoted to be chief executive of Sanford Bernstein, an investment-management and research firm that does no investment banking. In hiring her, Mr Weill appreciates that symbolic purity, and no doubt hopes the regulators do, too.

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Private-equity investment in Russia

Slim pickings

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From The Economist print edition

Despite attempts to clean up corporate governance, Russia is as risky as ever

AFTER Russia's financial crisis and currency devaluation in 1998, foreign money fled almost every Russian casino, sorry, capital market. Yet some investors see some good coming out of the mess. After the crisis, Russians, though addicted to imports, found them too expensive in rouble terms. That gave home-grown companies a chance. The perception of improved company performance has helped Russia's stockmarkets to count among the world's few good performers over the past year, although rising energy prices certainly counted for much more. Now, goes the thinking, some of those local firms could use foreign capital. And private-equity funds are putting out feelers again.

There is, as ever in Russia, the risk of expensive misperceptions. After all, it is not as though profitable opportunities are going begging for a bit of western cash. Russia is awash with local money looking for things to invest in, or would be if it all flowed back from Cyprus. Then there are the extreme handicaps of doing private business in Russia—ranging from a corrupt and murky legal system to a shortage of good managers. Even a sharp western investor, Kohlberg Kravis Roberts, an American buyout fund, had its fingers badly burnt by an investment in Lomonosov, formerly a state-owned porcelain factory in St Petersburg. Almost all the big private-equity funds in New York and London still shun Russia. So who would bet on creaky mid-sized Russian companies in the hope of transforming them into something bigger and better?

One of the most successful has been Baring Vostok Capital Partners, which between 1994 and 1998 reaped a 70% internal rate of return on one of its funds. On the back of that record, it raised a $205m fund last year from western institutions, of which three-quarters has now been invested. Its funds' bets include CTC, a private television network, and Air&Space, makers of air-filtration systems. Yet the firm has not yet found a profitable exit—that is, buyers—for its technology and media investments. Indeed, much of Vostok's earlier success was in investments in publicly quoted oil-and-gas firms, leading some to wonder when the returns from a broader set of unquoted businesses will ever come to be realised.

Hardly any private-equity funds in Russia completely fit the western mould. David Herne, a fund manager with Brunswick Capital Management, says that the line between private and public equity in Russia is blurred. After all, improving management through big stakes is what any investor, in quoted or private companies, is aiming to do in Russia. Passive investing is simply not worth the risk.

William Browder of Hermitage Capital Management, which invests in publicly traded equities, warns about the legal risks of private equity in Russia: you would have to be crazy to invest in it, he says. The only improvements in governance have come through pressure on publicly traded firms, he reckons, when the power of the foreign press and foreign investors is brought to bear. Even so, he has been to court in 32 cases of shareholder litigation and lost 31 of them. Moreover, Mr Browder notes, with public firms trading on multiples of six or seven times earnings, private equity would be attractive only at valuations half as high—an unlikely prospect even in Russia.

One answer is to build your own business. Delta Capital, manager of a fund sponsored by the American government, has created its own mortgage bank, aimed at Russia's middle class. Such projects—though perhaps closer to venture capital than to traditional private equity—may be a better way to turn a penny in Russia.

Always, good local management is needed, and perhaps it is improving. In the boom years before the 1998 crisis, most local bosses had had a mere five or so years' experience of a liberal economy. Now, they are that much wiser. One fund manager is convinced that home-grown business managers do far better in Russia's wild markets than those returning home from more cosseted posts in New York or

London. They are also very much cheaper.

Finally, every foreign investor needs an exit strategy, and few are on offer. Best of all is to sell to a big foreign company, yet few are in Russia, with such exceptions as Nestlé, McDonald's and Ikea, which have experience in wild places and have built from the ground up. Still, expect more money to chase more deals as western pension funds and other institutions look farther afield in search of returns they can no longer get at home. Troika Dialog and Gleneagle, to name but two, are putting together multi-million-dollar funds.

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Rural pensions in China

Not in everyone's lifetime

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Country dwellers could use them

WHILE officials in urban China grapple with the problem of massive unfunded pension liabilities, in the countryside they have no such headaches. Few of China's more than 800m rural dwellers have any pension arrangements at all. Academics and officials in Beijing are now trying to devise a scheme to provide old-age security in the countryside. But where will the money come from?

China has tried and failed to provide rural pensions before. In 1992, a voluntary scheme was introduced whereby farmers would pay up to 20 yuan ($2.40) a month into collective pension funds (later changed to individual accounts because of mistrustful contributors). Local governments would match a proportion of the contributions and place most of the money in state banks. The idea was that, once a farmer turned 60, and so long as he had been contributing for ten years, he could draw a pension.

Yet by the late 1990s, when the government had $2.6 billion in funds, it gave up promoting the scheme. In poor areas, farmers could ill afford even the minimum contribution of 2 yuan, and local governments had no spare money to add. In richer places, farmers could see no point in making contributions with the prospect of minimal investment growth. Since 1996, interest rates on bank deposits have fallen to about 2%, while government bonds yield about 3%. Such rates cannot provide a pensioner with enough money to live on. Farmers also worried that their money would disappear into the coffers of corrupt officials. Only some 10% bothered to pay into the funds.

Yang Yansui, of the Centre for Employment and Security at Qinghua University in Beijing, believes the scheme is still salvageable. A month ago, Miss Yang's centre began a project with the Ministry of Labour and Social Security, and with insurance companies, to revamp the scheme. This would involve making better provisions for investments and allowing greater involvement by commercial insurance companies and stockbrokers, contracted by government trusts to manage the funds. It would also permit the huge numbers of peasants who move into cities to continue making contributions—a big omission in the earlier experiment. In China, such migrants are excluded from urban social-security provisions. Miss Yang says she and her colleagues plan to submit a proposal to the government early next year, but cautions that so far they have come up with “no good answers”.

Some academics argue that extending rural-pension coverage is becoming increasingly urgent as young people migrate to cities, leaving the elderly behind. At present, the main provision for the elderly is the small plot of land that the state allocates to farmers. Others argue that attempts to provide better pension arrangements may work in the richer coastal areas, but will never get off the ground elsewhere until economic conditions improve. The suspension of the first scheme has done nothing to boost the confidence of country dwellers who were sceptical about handing over their money in the first place. “We think it is urgent, but it is impossible to perfect it in the next few years,” Miss Yang admits.

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Hong Kong's currency board

What's in a peg?

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The debate about delinking the Hong Kong dollar heats up

Reuters

In Hong Kong, prices adjust

Get article background

HONG KONG'S peg—its dollar's steadfast link to the American dollar at a rate of 7.8 to one—is 19 years old this autumn. It has survived political crises and a number of booms and busts, including a massive speculative attack during Asia's financial crisis of 1997-98. Since the demise of Argentina's exchange-rate system in January, it is the world's main surviving example (with apologies to Djibouti and Estonia) of a successful currency board. Yet the territory is once more wondering about the peg's viability.

This time the debate was kicked off when, in September, a bellwether analyst at the Bank of China expressed his (private, the bank quickly added) opinion that Hong Kong would be better off without the peg. Then it emerged that a legislator had commissioned research into the merits of breaking the link. After some mayhem in the forward markets, the government quickly issued the customary pledge that the peg was inviolable. “The market likely will, and logically should, discount such official assurances,” says a currency strategist at J.P. Morgan Chase.

This says a lot about Hong Kong's pessimism in the face of an economic slowdown, a widening budget deficit, and persistent deflation. Prices have now fallen, year-on-year, for 46 months. The value of commercial property is down by 65% since the mid-1990s, and unemployment at 7.6% is high by Hong Kong's standards.

To its detractors, the peg bears most of the blame. Hong Kong's main challenge, the argument goes, is to integrate with the economy of mainland China. And since labour and property in neighbouring Guangdong province cost a small fraction of what they do in Hong Kong, but are less inferior than they once were, prices on both sides of the border must adjust. Without a depreciating exchange rate to take the strain, that can only mean falling prices in Hong Kong. This is not only painful but unfair, because it hits two groups disproportionately: property owners, many of whom have negative equity, and low-skilled workers, who face a choice between unemployment and falling wages. Scrapping the peg, by contrast, would spread the costs of adjustment among all consumers. What is more, the argument continues, Hong Kong would gain much-needed flexibility in monetary policy.

The peg's defenders counter, first, that devaluation would inflict new, perhaps worse, pain—and possibly instability. It is mainly Hong Kong's poor that save in local currency, so devaluation would rob their piggy banks. Second, why should devaluation accelerate economic restructuring? Elsewhere in Asia (in Thailand, for instance), devaluation may have boosted exports, but perhaps it delayed serious reforms by making them seem less urgent. Besides, in the case of Hong Kong, devaluation is unlikely to boost exports, since only one-tenth of its trade is denominated in local currency. As to the notion of monetary flexibility for such a small, open economy, Joseph Yam, the head of Hong Kong's monetary authority, reckons that Hong Kong could not avoid being bound to American monetary policy even without the link.

The case against the peg gets even harder when it comes to examining the alternatives. The volatility from a purely floating exchange rate would almost certainly damage the city's competitiveness as a financial centre. A managed float, as Singapore has, risks permanently politicising the exchange rate, and might invite speculators. Re-pegging to the dollar at a lower rate would lack

The volatility from a purely floating exchange rate would almost

credibility. In the long run, says Ian Perkin, an economist at Hong Kong's chamber of commerce, the most logical thing is to link with China's yuan. But this will not be an option for years, and certainly not before the yuan becomes fully convertible.

certainly damage the city's competitiveness as a financial centre

Hong Kong might do better if it concentrated more on adjustment in its real economy. Successful adjustment happens in two ways—through wages and through prices. It is true that wages have proved stickier during the downturn than many peg fans had hoped. Even though most wages have been frozen in the territory, that still means wage rises in real terms. And it is easier to lay people off than it is to negotiate actual pay cuts. In the long run, better education would raise productivity, which in turn would underpin both high employment and high wages.

As for prices, they are adjusting, most strikingly in property. So the peg is doing pretty much what it was meant to do. Not perfectly. But as John Greenwood, who helped design it in 1983, once said, the peg is the worst system—bar all the others.

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Economics focus

Productivity promises

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How much of America's surge in productivity growth can be sustained?

SHARP falls in consumer confidence have sparked fears that the economy is sliding into another recession. Yet over the past week, both the chairman and the vice-chairman of America's Federal Reserve Board have tried to draw attention away from such concerns, with upbeat speeches arguing that America's productivity miracle is alive and well.

Figures due to be published on November 7th are expected to show that output per man-hour in America's non-farm business sector grew by more than 5% in the year to the third quarter. That would be close to its fastest growth in 30 years. Productivity always bounces back in the first year of a recovery, as firms produce more with a leaner workforce. However, the recent spurt in productivity has been unusually strong, given that the recovery in output has been modest by historical standards. Is this evidence that the “new economy” has survived the downturn? Or does it simply mean that, after the deepest plunge in profits since the 1930s, companies had no choice but to slash costs?

The Fed's chairman, Alan Greenspan, accepts that some of the productivity gains are once-only affairs, as firms trim their fat. Yet he expects productivity growth to remain brisk for at least another decade, as the more efficient use of information technology (IT) spreads through the economy, and as previous investments pay off. The adoption of electricity from the late 19th century shows that it takes time for companies to reorganise more efficiently to reap the full benefits of a new technology.

Almost all economists now agree with Mr Greenspan's claim that trend productivity growth has increased. The contentious issue is: by how much? Early last year, many reckoned that America's structural productivity growth rate had risen to 3-3.5% a year. That now looks too optimistic, since average productivity growth in the six years since 1995 has been revised downwards, to about 2.5%. But even that is still 1.1 percentage points above the average growth rate of the previous two decades.

Stephen Oliner and Daniel Sichel, economists at the Federal Reserve, were among the first to document the jump in America's productivity growth. They have recently updated their earlier work to take account of revised data up to the end of 2001. They split the increase in labour productivity growth into two components: capital deepening, with workers using more machines; and what is called multifactor productivity growth, in which existing resources of capital and labour are used more efficiently. The latter is a better gauge of true productivity gains.

Mr Oliner and Mr Sichel find, on the basis of the latest data, that the mix in the increase in labour productivity growth has changed since their original study. More than the whole of the increase in productivity growth since 1995, compared with the early 1990s, now seems to be down to capital deepening (mainly in IT equipment), or to efficiency gains in the production of IT goods. Outside the computer industry, multifactor productivity growth actually fell slightly after 1995. This is in sharp contrast to findings in the authors' earlier work, which concluded that multifactor productivity growth in the non-IT sectors had accounted for one-third of the total increase in labour productivity.

More than the whole of the increase in productivity growth since 1995 now seems to be down to capital deepening or to efficiency gains

The composition of productivity growth helps to explain why, in the late 1990s, American profits slumped as a share of GDP. Profits depend not on labour productivity, but on growth in capital productivity, which fell in the late 1990s thanks to over-investment. Unless the return on investment improves significantly, firms will remain reluctant to invest in new IT equipment and in research and development. That, in turn, could trim labour

productivity growth.

Making assumptions about the pace of future technological advances in the semiconductor industry, and about the growth in IT as a share of GDP, Messrs Oliner and Sichel estimate that sustainable annual productivity growth over the next decade lies in a range of 2-2.8%. Mr Greenspan himself seems to be betting on the top end of that range. In other words, he believes that the trend rate of productivity growth may be higher than its actual rate in the late 1990s.

Bill Dudley, chief economist at Goldman Sachs, argues the opposite: that productivity growth in the late 1990s was inflated by unsustainable capital deepening. As the stockmarket bubble made capital artificially cheap, so firms over-invested. If future investment is more modest, productivity growth could slow. The recent increase in labour productivity growth has relied much more on capital deepening (which has accounted for as much as 90% of the total gains since 1995) than was the case in earlier technological revolutions.

Over the past year, capital spending has indeed fallen, yet labour productivity has surged. This, Mr Greenspan argues, suggests that multifactor productivity growth must have increased. Perhaps, but that still says nothing about how much of this is cyclical and how much is structural—and so sustainable.

Think modest

Mr Dudley reckons that trend productivity growth is just 2%. Not only is capital deepening likely to proceed at a slower pace in future, but other factors that had lifted productivity growth are also turning out less favourable. In particular, he notes that government spending is rising again as a share of GDP, which could divert resources away from more productive uses. The pace of trade liberalisation and deregulation, which helped productivity growth in the 1990s, has also slowed, if it has not reversed.

If labour productivity growth in the non-farm business sector is 2%, that would still be a worthwhile improvement on previous decades. It implies productivity growth for the whole economy (including the public sector) of less than 2%, which means that America's potential GDP growth rate is something under 3% a year. Not bad, but not as spectacular as Mr Greenspan posits.

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Trade in endangered species

Out of the blue

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ARDEA

This year's CITES meeting to regulate trade in endangered species will focus on fish—and see a clash between different flavours of conservationist

Get article background

IT CAN grow two metres long. It is found deep in the Southern Ocean around Antarctica. And it can live for 50 years. The Patagonian toothfish (or Chilean sea bass) is big and it certainly isn't pretty. But, according to some, it is endangered and restrictions are needed on its trade.

Meetings of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) are traditionally associated with arguments about what is known, somewhat cynically, as charismatic megafauna—elephants, rhinos, tigers and so on. But fishing is a much bigger big business than the trades in ivory, rhino horns and tiger blood were before they were banned by CITES. So the fact that the CITES meeting starting next week in Santiago, Chile, plans to stick its nose into the subject is likely to cause political hackles to rise.

Wild at heart

CITES protects species whose existence may be threatened by international trade. Any member state may propose a listing, at a meeting that takes place every two years. Members then vote on the proposal to put a species into various appendices. Appendix I means that international trade is generally banned; Appendix II regulates trade using permits. Australia, one of the main toothfishing nations, has proposed that the Patagonian toothfish be listed in Appendix II.

If the proposal goes through, it will set a precedent. A debate has raged for years over whether commercially fished species should be dealt with by CITES. One argument against has been that commercial species are best managed by multilateral agreements. But conservationists assert that such an arrangement has already failed the toothfish. Gerald Leape, director of the marine conservation programme of the National Environmental Trust, a lobby group based in Washington, DC, says that, of the 56 countries that trade in toothfish, only 24 are members of an existing regional agreement to manage the species. All, however, are members of CITES.

Australia's proposals have the support of most of its domestic toothfishing industry, mainly because this legal fishery is so threatened by pirates. Traffic, a wildlife trade monitoring group, has estimated that at

least half of the catch landed could be illegal. That does not worry purchasers, however. Big importers of the toothfish, particularly Japan, and industry groups representing importing companies, such as America's National Fisheries Institute, object to the listing.

There is also likely to be an argument about a proposal to tighten restrictions on trade in basking sharks (the species illustrated above, whose fins are used in soup) by listing the fish in Appendix II. Because Japan and Norway, two of the countries most heavily involved in the shark trade, are not currently obliged to declare their trade in this species, they don't. That is fair enough. But they then use the absence of data that their refusal causes as an argument that there is no evidence that the trade actually exists.

This is sophistry on a level that Machiavelli would have admired. In any case, market signals suggest that basking sharks do face a problem. Kuniaki Takahashi, a Japanese shark-fin trader, is so convinced that stocks are collapsing that a few years ago he cornered the market in Norwegian shark fins and stockpiled the result in Japan. He still seems confident that his stockpile will make him a fortune.

Small fish, too, are endangered by trade. The convention's members are, for instance, considering putting all 32 species of seahorse into Appendix II. Between 1996 and 2000, the number of countries trading seahorses (mostly for their purported medicinal value) more than doubled, and the volume traded went from 45 to 70 tonnes (at least 24m specimens).

Unlike toothfish and sharks, however, seahorses are cute. They might, indeed, be described as charismatic microfauna. And their tale illuminates another aspect of this CITES meeting—a debate about what motivates conservation.

Use it or lose it

Research on whether seahorses should and could be listed was led by Amanda Vincent, a marine biologist at McGill University, in Montreal. Two years ago she opposed a proposal to list them. She felt that basic work had not been done on the volume of trade in the various species, on the way the fisheries were managed and on surveying the opinions of fishermen. It has been done now, though, and Dr Vincent is backing the current listing proposal. But she says that two years ago, she came under extraordinary pressure from some organisations, including America's wealthy Humane Society, to support what she regarded as premature listing.

Dr Vincent is one of several experts who are concerned about the influence that animal welfare (and animal rights) groups have over CITES. Some welfare groups, she says, would rather there was no trade at all in many species, regardless of the actual threats they face. Wolf Krug, a researcher on social and economic issues at University College, London, agrees. He believes there is an ideological clash between “welfare” and “sustainable-use” conservationists. The sustainable-use lobby takes the view that the long-term future of a species is best ensured by making money from it. This group fears that a trade convention is being undermined by welfare-driven proposals.

By contrast, Teresa Telecky, director of the wildlife trade programme at the Humane Society (and also acting director of the Species Survival Network, a collection of groups that are lobbying CITES) believes that welfare and long-term survival are congruent objectives. “The ultimate cruelty”, she suggests, “is for a species to become extinct.” She adds that CITES is “not about sustainable use” and that “animal welfare is written into the treaty because in order to export live animals you have to be prepared to ship humanely.”

Dr Telecky is correct that the convention's core aim is to ensure that trade does not threaten the survival of wildlife, and that this does not, technically, mean that its remit is to ensure the perpetuation of trade through sustainable use. But it is disingenuous to argue that animal welfare is closer than sustainable use to the convention's spirit. John Jackson, of Conservation Force, a group that supports sustainable use, describes Dr Telecky's arguments as hogwash. He says the Humane Society's true agenda can be seen in its “vicious” attack on Zimbabwe's Campfire project.

This project, which works on integrating the use of wildlife into rural development programmes, supports the licensed killing of elephants by trophy hunters—a lucrative practice that does not threaten elephant numbers. Dr Telecky agrees that her society put “a lot of heat” on the American government over the $20m a year subsidy which it was giving to Campfire. That subsidy has since been phased out.

All this suggests that the time is approaching when members of CITES are going to have to decide whether to support the poor-world agenda of sustainable use, or the rich-world agenda of welfare. Perhaps the fact that most endangered species are in the poor world should be allowed to colour that choice.

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Elephants v farmers

Bee off with you

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Scaring elephants away could save them from angry farmers. But how to do it?

Get article background

ELEPHANTS, proverbially, are afraid of mice. Well, it's a nice story, but don't rely on it to frighten the beasts from your smallholding. Poachers aside, the most dangerous thing an elephant is likely to meet is a disgruntled farmer with a rifle. And farmers have good reason to be disgruntled. In many parts of Africa, farms are routinely trashed by visiting elephants. In this case, therefore, prevention is better than cure for both sides. And some work just published by *Naturwissenschaften* may point the way, using tiny creatures that elephants really are afraid of: bees.

Although elephants are thick-skinned, they have sensitive patches behind their ears, under their trunks and around their eyes. Sometimes, according to bee-keepers, an entire herd can be stampeded by a swarm of bees. So Fritz Vollrath of the Mpala Research Centre and Iain Douglas-Hamilton of Save the Elephants, both based in Kenya, have tested the idea that elephants' visits to farms might be discouraged by strategically placed bee hives. It seems they are—and that the hives do not necessarily even have to be occupied.

Dr Vollrath and Dr Douglas-Hamilton hung their hives in acacia trees on a ranch in central Kenya. Apiculture is an established industry in this area, and tree-hanging hives of standard design are readily available. The two researchers used six occupied hives, and also 30 empty ones that had been primed with honey in order to smell as though they might be occupied. They deployed them in two well-known elephant foraging areas, where trees are routinely browsed by the beasts. They also chose 36 other trees, similar to those in which they had hung hives, as controls.

Hanging an occupied hive in a tree turned out to be very effective. None of the trees thus protected suffered damage. Trees with unoccupied hives got some protection as well. Although they were subjected to light browsing about as often as control trees, none suffered substantial damage. In contrast, nine of the controls were seriously damaged by the attentions of elephants.

Hanging hives in a farm would not be a cost-free option. Bees attack people, too, so bee-keepers would be needed. On the other hand, honey is a valuable commodity, so apiculture might prove a profitable sideline for farmers. If it could be labelled “elephant friendly”, it might even turn into a premium product.

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Game theory

NP or not NP?

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Tetris, a popular computer game, turns out to be hard for a reason

TETRIS, a computer game invented in 1984, has sold over 60m copies. It is played by organising a sequence of falling blocks in a rectangular well. If a line of the well fills up, it disappears and the blocks on top of it drop down. When there is no room for further blocks, you lose.

The reason Tetris is so popular is that it is easy to learn but hard to master. Just how hard is shown in a paper that Eric Demaine of the Massachusetts Institute of Technology is about to present to a workshop on computational geometry. Dr Demaine and his colleagues have demonstrated that Tetris belongs to a class of mathematical problems known as NP-complete. It thus joins the “travelling salesman” problem, in which a salesman wishes to find the shortest route between the cities he has to visit. Solving that, or allied problems such as the best way to route airliners or fleets of lorries, or to pack boxes into a warehouse to save space, could save huge sums of money. So solving NP-complete problems is more than just a game.

One characteristic of NP-complete problems is that they get rapidly harder as the number of terms (ie, the number of blocks or cities) increases. There is no practical way to solve such problems if the number of terms is too large. But another characteristic is that if a fast way could be found to solve just one of them, they could all be solved quickly using the same method.

Nobody has yet found such an answer. To do so, a mathematician would have to show that NP-complete problems are equivalent to another class of problem, P problems, in which complexity grows relatively slowly with the number of terms. In mathematical jargon, that would mean showing that P=NP.

Most mathematicians believe that P and NP are not, in fact, equal—although none know how to prove that, either. For the lucky person who manages to prove either that P=NP or, contrariwise, that it doesn't, a prize of $1m awaits, courtesy of the Clay Mathematics Institute.

Few mathematicians are betting their futures on finding any such proof. Instead, their efforts are focused on techniques for NP-complete problems that would yield good (but not perfect) solutions for most cases, a field of study aptly known as approximation theory. Even if the mathematical consensus is right, though, it may eventually be possible to solve NP problems quickly. Several theorists have proposed using quantum computers, if and when such things are built, to do so. These computers would bring some of the weirder effects of quantum theory to bear on the matter—including, according to some physicists, an ability to borrow computing power from parallel universes. What a game of Tetris would be like on a quantum computer is anybody's guess.

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50 years of the H-bomb

Living in Mike's world

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Reuters

Many happy returns?

THE news associated with this picture is that there is, fortunately for humanity, no news. It is a photograph of the explosion caused by Ivy Mike, the world's first hydrogen bomb. Mike was detonated exactly 50 years ago, on November 1st 1952.

It is easy to lump all nuclear weapons together, and to dismiss them as equally dangerous. But hydrogen bombs, which derive most of their power from the fusion of light atomic nuclei, are far more terrible than fission bombs, which work by splitting heavy nuclei. Mike was 500 times more powerful than the atomic bombs dropped on Hiroshima and Nagasaki. The long-term effects of radiation aside, those fission bombs caused casualties and damage similar to that suffered by Tokyo, Hamburg and Dresden in conventional air-raids. By contrast Elugelab, the Pacific island on which Mike exploded, was erased by the blast.

When told that Elugelab was “missing”, America's president-elect, Dwight Eisenhower, visibly paled. Be thankful, then, that unlike almost every other weapon invented in the history of warfare, hydrogen bombs have never been used in anger. So far.

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Solar energy

Power tower

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A novel way of generating electricity

SOMETIMES the simplest ideas are the best. And what could be simpler than the idea of generating electricity from the updraft of a chimney by putting turbines inside that chimney? If the hot air that goes into the bottom of the chimney were heated by the sun, the whole arrangement could be fuelled for nothing. Indeed, it is such a good idea that somebody now plans to do it. The snag is the size of the chimney: it will be 1km tall.

EnviroMission, an Australian firm, hopes to start building its “solar tower” next year. The proposed site is a place called Buronga, in the south-east of the country. The Australian government gave its blessing in June—and so, in October, did the state government of New South Wales.

The solar tower will, in effect, be a vertical wind farm. The chimney will be surrounded by a shallow, circular, acrylic greenhouse, 7km in diameter, that will provide the hot air. This will travel up the tower at 60kph. The electricity—200MW of it—will be generated by 32 turbines located in the chimney's base. Although heat that accumulates in the ground under the greenhouse will allow it to operate at night as well, the solar tower's maximum output will come during the day. But since that is when demand is highest, due to the need to power air-conditioning units, the tower's production should automatically follow peaks and troughs in demand.

The whole thing will cost A$800m ($440m) to build, and although EnviroMission is being cagey about the economic details, it claims that the power produced will be competitive with that generated from Australia's vast coal reserves.

That is an impressive claim, given that Australian coal is among the cheapest in the world, and electricity generated from it costs about 4.5 Australian cents a kW-hour. The truth is that the numbers depend on carbon-trading arrangements that Australia is putting in place as part of its effort to reduce greenhouse-gas emissions. EnviroMission will receive tradable “renewable energy” certificates that the company believes will, coincidentally, be worth 4.5 Australian cents a kW-hour.

There could also be another source of revenue. The tower is likely to become a tourist attraction. It would be by far the tallest structure in the world, visible from a distance of 100km on a clear day. Which, of course, means most days—otherwise Buronga would not be the chosen site.

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About sponsorship

H. L. Mencken

A good hater

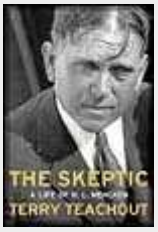
Oct 31st 2002
From The Economist print edition

Smug elites, religious bigots, mass culture and popular ignorance—all were targets of his untamed wit

QUESTION: If you find so much that is unworthy of reverence in the United States, why do you live here? Answer: Why do men go to zoos? The combative humour is typical of H. L. Mencken (1880-1956), the toughest social and literary critic in America during the age of flappers, jazz and bathtub gin, of Al Capone, Calvin Coolidge and Mary Pickford.

His latest biographer, Terry Teachout, clearly demonstrates the injustice of the calamitous decline in Mencken's reputation from the peak it reached in the 1920s, when Walter Lippmann called him “the most powerful personal influence on this whole generation of educated Americans”, to the depths it touched on the publication of his time-sealed private papers more than 30 years after his death. His diaries, letters and autobiographical notes were then found to contain rude comments about blacks and Jews that scandalised people unfamiliar with his boisterous style and his raucous era.

The Skeptic: A Life of H. L. Mencken
By Terry Teachout



HarperCollins; 432 pages; $29.95

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Among the admirers who came to his defence with a letter to the *New York Review of Books* were Kurt Vonnegut, Norman Mailer, Arthur Miller and Ralph Ellison. So what?, these authors said. The Mencken papers contained rude remarks not just about blacks and Jews but about most races, nations and professions. Mencken, whatever his prejudices, should, they said, be celebrated and remembered as a tremendous liberating force in American culture.

In a lucid and intelligent biography, Mr Teachout confirms that Mencken's prejudices were almost unconfined. The only country he really admired was Germany—a partiality that got him into trouble during the first world war when not a single editor anywhere in the United States would publish his work. For Mencken, the American South was the land of Coca-Cola, hookworm and Holy Rollers. The English were sly, clergymen were cranks and the common man was uncommonly thick. He looked down on sportsmen and all forms of exercise, claiming that the foul smell of the gym “suggests a mixture of Salvation Army, elephant house and county jail”. And he purported to view most politicians, from presidents upwards, as vermin.

But, as Mr Teachout shows, there was more to his subject than a marvellous talent for mirthful abuse. As a journalist Mencken campaigned hard for civil liberties and against southern injustice. As a literary editor, he championed the early work of Sherwood Anderson, Willa Cather, William Faulkner, Ezra Pound and F. Scott Fitzgerald, and he could fairly claim to have discovered and promoted Sinclair Lewis, the author of “Main Street”, “Elmer Gantry” and “Babbitt”.

As well as translating work by the German philosopher Friedrich Nietzsche into English, and writing newspaper columns about everything from Schubert and hot dogs to the Ku Klux Klan and sauerkraut, Mencken also produced at least two works that will endure. They are his Johnsonian study of the American language and his three-volume autobiography.

The first autobiographical volume, “Happy Days”, is a vivid, funny account of his boyhood in Baltimore in the 1880s. The American reading public loved it. So did the critics, who bracketed it with an American classic, “Huckleberry Finn”. Nothing in his life pleased Mencken more. Mark Twain was his literary hero and had the greatest influence on his professional life.

Mr Teachout's singular achievement is to discern a coherent strain in Mencken's elitist-libertarian thought. Unlike most American conservatives, he argues, the Sage of Baltimore was primarily interested in social questions, not economic ones. His principal target was not socialism but democracy—or, more precisely, the unrestrained populism to which democracy can lead. Such nonsenses as the prohibition of alcohol and of the teaching of evolution were, for him, a consequence of paying excessive regard to the ignorant opinions of the common man. Yet he believed in progress, though he was loth to admit it. He “looked at evil and saw ignorance” and he subscribed to the idea that science, especially eugenics, might yet save the world. “Every time the scientists take another fort from the theologians and the politicians there is genuine human progress.”

In later life, Mencken's politics turned rancid. He began to sound unhinged as he denounced his enemies in general and President Franklin Roosevelt in particular as quacks and swindlers, fools and knaves. By the mid-1940s he began to resemble the narrow-minded provincials he so despised. On workdays, he dressed like the owner of a country hardware store; on ceremonial occasions, like a plumber got up for church.

But even in the years of his sad decline, Mencken was hardly ever pompous. In his native Baltimore, a blue-collar harbour town, the story is still told about how he once read his own obituary in the files of the *Sun* newspaper, and did not change a word except to add a final sentence: “As he got older, he got worse.”

The Skeptic: A Life of H. L. Mencken.
By Terry Teachout.
HarperCollins; 432 pages; $29.95

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About sponsorship

French history

A drama, not a balance sheet

Oct 31st 2002
From The Economist print edition

THE French 18th century is a magnet both for researchers and the general reader. France was the centre of that intellectual seedbed of modernity, the Enlightenment. It was a superpower able to spread its influence round the world. It was a motor of economic globalisation. And of course, in the revolution of 1789, it invented a Utopian vision that illuminated—or darkened—two centuries.

This famous historical saga has been rejuvenated over the last generation by the abandonment of quasi-Marxist explanations of the revolution as the inevitable outcome of socio-economic forces. Historians have become fascinated by more fluid and unpredictable causes, such as beliefs, customs and identities. This means not only explaining the course of history in new ways, but also accepting that the course itself could have been different. Human choices matter. So history is again a drama, not just a balance sheet.

These two books embody new and distinctive visions. Colin Jones has written the first general history of 18th-century France in English for 40 years, and has placed all rivals in any language in the shade. David Garrioch has written the first general history of 18th-century Paris in English, and the only single-volume work in any language. Both, while incorporating the latest academic research, have written for a general readership, and in this difficult task are triumphantly successful. Both use narrative, spend little time on theory and confine themselves to plain language. This, the art that conceals art, requires an intimate understanding of their subjects, and a painstaking concern to balance analysis and story.

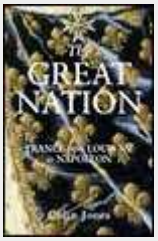
Mr Jones's ability to transmute a complex century into some 600 pages of fast-paced and lucid prose is exemplary. It is a pity there are no pictures. He begins and ends with Louis XIV's and Napoleon's shapely legs—a light-hearted nod to the modish history of the body—but his focus is really on politics and the state. Mr Garrioch shows how Paris worked as a community, or rather a collection of communities, and his vivid viewpoint is from the street, not the court.

Both authors are concerned with change, conflict and breakdown, yet their intellectual starting-points differ. Mr Garrioch, as his title shows, wants to explain how Paris—considered by contemporaries as peaceful, deferential and well governed—became the revolutionary volcano of 1789-99. But Mr Jones explicitly refuses this retrospective view: his 18th century is not merely a prelude to revolution.

There are problems with both approaches, which is less a criticism of the authors than a reflection of tantalising post-Marxist uncertainty. Mr Garrioch concludes that the city was losing its old corporate foundations of parish and guild, thus becoming more turbulent and unstable, and that this conditioned the way the revolution took place. True in a sense: but these changes just made Paris more like London, which had the frightening Gordon Riots in 1780, but no revolution.

Clearly we must look outside the city for the revolution's causes. Mr Jones gives his readers all the information, but, perhaps because of his self-denying ordinance mentioned above, does not spell out his own conclusions, and the book just stops. Its final comparison of monarchical legs suggests, unsettlingly, that the wheel had come full circle and the struggles had been futile. Yet this does not square with the “awe” for the revolutionary values of 1789 he expresses in the introduction. The enigma may leave some

The Great Nation: France from Louis XV to Napoleon, 1715-99
By Colin Jones



Allen Lane/The Penguin Press; 688 pages; £25

Buy it at
Amazon.co.uk

The Making of Revolutionary Paris
By David Garrioch

University of California Press; 396 pages; $34.95 and £24.95

Buy it at
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readers (especially students wanting answers) feeling slightly cheated, and others intrigued. One response would be that the main cause of the French revolution lies outside Mr Garrioch's Paris and beyond the grasp of Mr Jones's elite: in the unrelenting global conflict with Britain that undermined the French state and thrust the country into increasingly unmanageable crises.

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About sponsorship

Men's biology

On not being a woman

Oct 31st 2002
From The Economist print edition

STEVE JONES, a professor of genetics at London University, is an accomplished and successful scientific populariser. A previous book “Almost Like a Whale” was based on Darwin's “Origin of Species” and his new book, in its title and here and there in the text, makes reference to Darwin's “The Descent of Man”. However its style, to say the least, is different. Mr Jones instructs by way of jokes, diversions and generalisations: his new book is an entertaining hotch-potch of information about the Y chromosome and the male sex.

Female members of the human species, like other mammals, have two similar sex chromosomes, the X chromosomes, but males have one X and one Y. All female sex cells (the ova) carry only one X; spermatozoa carry either an X or a Y. When an egg is fertilised by a sperm bearing a Y chromosome, there is a month's delay before it switches on the genes that convert the developing embryo into a male. Thus the default position is female. Mr Jones points out that man, not woman, is the second sex. Man's struggle is to not be a woman—not quite the traditional belief that man is the bearer of our human heritage and woman is derived from Adam's rib, nor Freud's view that women are diminished men.

Y: The Descent of Men
By Steve Jones

Little, Brown; 280 pages; £14.99. To be published in America by Houghton Mifflin in April 2003

Buy it at
Amazon.co.uk

Testosterone, described as the “virile essence”, is responsible for secondary sexual characteristics, including bald heads (and beards). Mr Jones capriciously suggests that testosterone has driven Russian politics since the 1917 revolution, because Soviet leaders from Lenin (bald) to Stalin (hairy) to Khrushchev (bald) to Brezhnev (hairy) and so on, were alternately reformers and reactionaries.

That the voice of a boy treble breaks about four years sooner than in Bach's time is related to the action of a hormone released from adipose tissue (fat cells) and the fact that children in richer countries weigh more than they used to. The disadvantages of being male (in biological terms anyway) are clear: from conception on he is less likely to survive (and now to graduate) than his sisters, his immune system makes him more open to infection and to cancer, he is more likely to be dyslexic, to break the law and to kill himself.

A chapter “Hydraulics for Boys” (“Love starts with chemistry but ends in physics”) is filled with slightly coy information about “man's most intimate machinery”, its function and dysfunction, and, of course, comparison with the whale. He claims that “in 1998 the erectile organ attracted a Nobel prize”—not exactly true. The citation concerned nitric oxide as a signalling molecule in the cardiovascular system, although it was later discovered to play a part in blood vessels responsible for an erection. A whole chapter, “Man mutilated”, is given to circumcision (and the author's disapproval).

Mr Jones enjoys rumours and astonishing facts; he cites the classics and the Bible. He has tolerant, liberal-minded views on man's behaviour and, as a good geneticist, stresses that the environment plays a big part in the expression of genes. His book is a diverting and racy read, though accuracy is sometimes sacrificed to a good story.

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Little, Brown; 280 pages; £14.99. To be published in America by Houghton Mifflin in April 2003

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New fiction

Odd company

Oct 31st 2002
From The Economist print edition

PROBABLY the wrong way to approach John Banville's new novel is as a detective, hunting for what it means. He is so generous with clues that it is tempting to deconstruct, to work out who is modelled on whom, to note the links with previous novels, to ponder the sense of every sign, name and shadow. But for this lazy reader, the pleasure was to relax and be carried by a blast of words and images on an enjoyably bizarre journey.

Of course the messages cannot, and should not, be ignored. The most insistent is the mistiness of identity. The anti-hero, Axel Vander, is a famous old literary critic, arrogant, lecherous and cruel, mendacious and a thief, possibly even a killer (Mr Banville's magic is that he makes one care about the monster). Fifty years earlier, he stole an identity and he lies unceasingly. He betrayed and was betrayed. “I have turned my coat so often,” he says, “that it has grown threadbare”. He comes from America to Turin to meet a girl, Cass Cleave, who has discovered that he is not who he pretends to be. Improbably, the two of them go to bed.

Shroud
By John Banville

Picador; 408 pages; £15.99. To be published in America by Knopf in March 2003

Buy it at
Amazon.co.uk

As a tale, it is unconvincing. Cass Cleave, a character from an earlier novel who suffers from hallucinations and black-outs, never really comes to life. Parts of the story, such as the flashback to Jews escaping from wartime Antwerp, are summary. There are no surprises in the revelations. Some critics have chided the book for fine writing at the expense of substance, and they have a point.

Even so, the novel works its wonders. It builds up the character of the treacherous young man turned scrawny old satyr as he sheds and assumes his identities. His stumbled, tragic odyssey through the city with his disordered girl is gripping: a grotesque Harlequin with his sad Columbine. They want, but fail, to see the shroud of Turin. Instead, they are pursued by shrouded, faceless symbols.

That makes the book sound portentous. In fact a lot of it is quite funny (“nothing like a good deep chestful of cigarette smoke to quell a morning cough”), minor characters are pleasantly odd and each sentence is as fresh as if it were new-born. Behind it all is the niggling question of what goes on, or may go on, “between actuality and the mind's apprehending”. Mr Banville leaves it to the reader to find what answer he can.

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By John Banville.
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About sponsorship

British television

The last of the old guard

Oct 31st 2002
From The Economist print edition

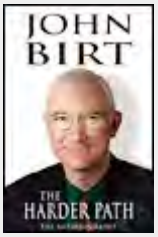
STATE-RUN broadcasting fills an awkward role in a mature democracy. So it is no surprise that the British Broadcasting Corporation (BBC) should find itself targeted at frequent intervals by politicians and rival media bosses who want to see it diminished or dismembered.

John Birt believes that, when he arrived at the BBC in 1987, its survival was in doubt. By the time he left in 2000, after seven controversial and often painful years as director-general, he had transformed it into a leaner, better managed organisation, its funding secure for the medium term. He has every right to be proud of his achievement, carried out in the face of opposition from entrenched interests.

But there is a gap in his tale of triumph over the forces of reaction, those he calls the “cultural buffaloes”, the “old soldiers, sniping with their muskets”. In a longish book, he devotes only two pages to discussing what is surely the central issue. As he puts it: “Why, in a world of proliferating TV and radio networks, do we need a BBC at all?” His answer is that a state broadcaster has a special, public-interest job of protecting the nation's culture and traditions while offering original and challenging fare. Yet the truth is that, despite Mr Birt's vision of his task, the BBC's two main television channels are today more and more commercial in all but ownership and control, programming as they do trivia that could come equally well from the privately owned channels. The BBC is winning the ratings war as a result but minority audiences are worse served.

A different problem arises with news and current affairs. Although governments nod to the corporation's editorial independence, they can be tempted to use their muscle as paymaster to influence coverage of contentious matters—especially, in recent years, Northern Ireland. Mr Birt's record in resisting such pressure was exemplary. But nowhere does he make the point that, under a truly independent regime of ownership and regulation, he would not have to confront such issues at all. The other side of that argument, it has to be said, is that under a commercial system, there would be less room for serious news: the model of the American networks is scarcely one to aspire to.

John Birt: The Harder Path
By John Birt



Time Warner Books; 544 pages; £20

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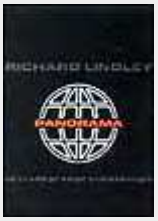
Panorama: 50 Years of Pride and Paranoia
By Richard Lindley



Politico's Publishing; 400 pages; $32.95 and £18.99

Buy it at
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Reforming news and current affairs was Mr Birt's first and probably his toughest task at the BBC. When he arrived he found a complacent coterie of journalists and executives convinced that their operation was the best in the world. Mostly privately educated, they evinced an air of superiority that grated with Mr Birt, who seldom lets us forget that his roots are in working-class Liverpool. When he told them that their journalism too often lacked direction and rigour they were incensed, and began leaking hostile stories about him to their friends in the press.

One of the focal points of the anti-Birt movement was the weekly current affairs programme “Panorama”, steeped as it is in lore and tradition. Since its launch in 1953 it had achieved a degree of autonomy that Mr Birt found intolerable. Richard Lindley, a former “Panorama” reporter, describes in his history of the programme how in the early years a group of exclusively male reporters set a style of self-regarding arrogance that dogged it for generations. Rivalries were poisonous, based on the principle that it was not enough to succeed: others had to be seen to fail.

Although Mr Lindley clearly disapproved of Mr Birt's assault on the “Panorama” establishment, his own

book shows why it was needed. He believes that the programme has never achieved the ratings success of CBS's “60 Minutes” in the United States because apprehensive controllers would not let reporters build themselves up as attractive personalities in the manner of Mike Wallace and Morley Safer.

Mr Birt takes an opposite view: “I wanted judicious journalism, not reporters preening themselves, full of half-baked opinions and their own sense of self-importance.” He prevailed and, like most of the BBC's news coverage, “Panorama” is today better in content than for some years, although relegated from Monday peak time to a Sunday night slot by Mr Birt's successor, Greg Dyke.

Mr Birt tried to strike a balance between a public-service broadcaster's duty to provide serious programming and the need to compete with the commercial sector for a mass audience. If that balance continues to shift down market, Mr Birt, once vilified as a Thatcherite scourge, may yet come to be seen as the last of the old guard.

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By John Birt.
Time Warner Books; 544 pages; £20

Panorama: 50 Years of Pride and Paranoia.
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About sponsorship

French and Italian popular films

National champions

Oct 31st 2002 | PARIS AND ROME
From The Economist print edition

Two children's films are a reminder that Europeans can also make box-office hits

ONE of Italy's greatest directors, Federico Fellini, always wanted to make a film of Pinocchio with the country's funniest actor, Roberto Benigni. But Fellini died without realising his dream, and now Mr Benigni has done it for him. His “Pinocchio”, which he wrote with Vincenzo Cerami, made a record $20m in its first ten days on Italian screens.

Is the B for “burlesque” or “Berlusconi”?

As with almost everything Mr Benigni touches—remember “Life is Beautiful”, a Chaplinesque comedy about Nazi camps?—along with the laughter comes controversy. After the financial upsets of Vittorio Cecchi Gori, a media mini-mogul and football-club chairman who was to have distributed “Pinocchio”, the film was taken over by the company of the mega-mogul (and prime minister) Silvio Berlusconi. Previously, Mr Benigni's comic lash has never spared Mr Berlusconi in any guise. Recently the actor has been more careful to distinguish the roles of prime minister and film distributor.

“Pinocchio” is a great Benigni show from start to finish, and visually spectacular. Unlike in Disney's classic 1940 cartoon, Pinocchio is a flesh-and-bones puppet, which gives Mr Benigni's talents full rein. Carlo Collodi's late-19th-century children's tale of a pinewood puppet come to life needs no embellishment. But here and there Mr Benigni adds a contemporary touch, including a swipe at Italian justice.

In France, too, local heroes are top in the box office. Mix a fictional icon, Astérix, with a real one, Gérard Depardieu, and in the French cinema success is guaranteed. So far this year the heroic Gauls have persuaded 14m French men, women and—especially—children to see this second attempt using actors to bring the cartoon characters of Astérix and his giant sidekick, Obélix, to the screen.

“Astérix et Obélix: Mission Cléopâtre”, whose budget was around $50m, has already grossed around $75m, with more profit to come. It also sets a modern viewing record for a French film (only “La Grande Vadrouille”, with 17m tickets sold in 1966, has done better). Moreover, though America's “Titanic”, with a French audience of 20m, holds the absolute record, Mr Chabat has easily surpassed the 9.3m audience for Harry Potter.

The music is a stirringly eclectic mix of rap and American pop; the costumes are suitably over the top (or, indeed, halfway down the bottom for the delectable Monica Bellucci's Cleopatra); and, quite apart from the outrageous puns and cinematic allusions, there is plenty of fun in seeing how Cleopatra's palace

can be built in three months thanks to Panoramix (Claude Rich) and the energising effects of his magic potion.

On the other hand, Mr Depardieu, impressively overweight as Obélix, strolls too lazily through the film and Christian Clavier's Astérix might as well be invisible. The true stars of the film are Jamel Debbouze, as Numérobis, Cleopatra's reluctant architect, and Gérard Darmon, who manages some wonderfully evil facial expressions as his slighted rival Amonbofis. Add some cameo parts for the comic stars of French television, plus an impressive performance from Obélix's dog, Idéfixe, and the ticket-buyers get their money's worth. If the punning survives the translators, perhaps the same will be true as the film opens now in Britain and in America next year.

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About sponsorship

Norbert Schultze

Oct 31st 2002
From The Economist print edition

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Norbert Schultze, writer of “Lili Marlene”, died on October 14th, aged 91

YOU switch on the television at random. Looks like a foreign scene. The melancholy background music sounds familiar. Ah, “Lili Marlene”. Must be a wartime movie. Is there any other tune that so instantly evokes a time and a place? Some might say “As Time Goes By” in “Casablanca”. But that was a song about American wartime yearnings. “Lili Marlene” became widely popular on both sides in the second world war.

It was the work of Norbert Schultze, perhaps Germany's most successful composer of tuneful music in the 1930s and 1940s. He wrote a simple melody to a wistful poem written by a German soldier in the first world war and had it recorded by Lale Andersen, a smoky-voiced cabaret singer whose rendering is regarded by connoisseurs as still the best.

The song seems first to have been taken up by Germans fighting under Erwin Rommel in the North African desert. It crossed the lines to the British, who were at first worried that their soldiers' morale would be undermined by a German song, but later came up with an English-language version, much played by forces' radio stations. A French version became a hit in German-occupied Paris and, after the United States entered the war in 1941, Marlene Dietrich claimed it for her own at concerts for American forces. The song's popularity continued after the war and got into the Japanese charts in 1986.

At the latest count there are 48 translations of the ballad from the German, including a version in Hebrew. The words by Hans Leip, aged 19 at the time, that Mr Schultze rescued from obscurity have the universal and un-nationalistic theme of separation: of a soldier sent to the front and his girlfriend waiting for him.

At least three films have been made about the story behind the song. One, starring Lale Andersen, was made by Mr Schultze himself. Another was a fairly awful British comedy. The most interesting, simply called “Lili Marlene”, made by Rainer Werner Fassbinder in 1981, has Joseph Goebbels, Hitler's propaganda chief, hating the song for its sentimentality. It is, Goebbels says, “crap, with the stench of death”. The film was not well received by the German public, but it gave yet another boost to the song, which once again became a hit.

Living with the Nazis

Norbert Schultze did his best to collect the vast royalties due to him from the many thousands of performances of his song, but without a lot of success. Many performers shrugged off his claims. The war was long over, and Mr Schultze had been on the wrong side. He said that he was never a Nazi but had taken “the comfortable route of the coward” in collaborating with the regime. He may have been too hard on himself. Many prominent Germans who established a *modus vivendi* with the Nazis did not think of themselves as cowards: it was, they said, their way of surviving.

As a young man Mr Schultze had considered a career in medicine: his father was a doctor. But his mother said he was a natural musician and young Norbert was sent off to study at a music academy in Cologne. By 1933, as Hitler was poised to take power, Mr Schultze, then 22, was completing his music studies, and, as it happens, was a star in a student cabaret that ridiculed politics. Goebbels sought control, not only of newspapers but of the main sources of public entertainment, and Mr Schultze was swept into the net.

In 1936 an opera he wrote for a children's audience, “Schwarzer Peter” (Black Pete) was tried out, with Elizabeth Schwarzkopf making one of her earliest appearances. It was an instant success and performed in some 100 theatres throughout Germany. After that, Mr Schultze could pick his commissions. A ballet followed, and then the music for his first film, followed by the music for several dozen films during the war. His music was too light for some tastes, but everyone agreed he had a popular touch. He was pleased with the success of “Lili Marlene” but did not rank it with what he considered his best work, such as “Schwarzer Peter”.

The “denazification” bodies set up by the victors after the war took a close look at Mr Schultze's work. They decided that his compositions “Bomben auf England” (Bombs on England) and “Vorwaerts nach Osten” (Ahead Towards the East) were simply patriotic pieces. They were worried that he had composed the background music for a film that had been scripted by Goebbels, and debated whether the composition conveyed Nazi ideology. He was asked why he wrote so well for the Nazis. Mr Schultze said he was puzzled by the question: how could an artist produce other than his best? In the end he was cleared, but for several years found it difficult to get work as a composer, and took a job as a gardener.

In the 1950s he was getting commissions again and wrote a number of musical comedies and operettas. All in all Norbert Schultze wrote hundreds of pieces of music. They form a footnote to the most momentous period of the 20th century, and are of interest to historians seeking to understand that time. Otherwise they are largely forgotten, except for one melody that Mr Schultze seems to have regarded as not particularly special.

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Overview

Oct 31st 2002
From The Economist print edition

America's consumers are worried about the weak job market, the prospect of war with Iraq and the stockmarkets, says the Conference Board. Its consumer-confidence index fell in October to 79.4, the lowest level in nine years, from a reading of 93.7 in September. The fall in confidence was the fifth consecutive monthly decline. Another measure of consumer sentiment, the University of Michigan's survey, also showed a sharp decline in confidence in October. Industrial output fell by 0.1% in September, but rose by 1.5% in the 12 months to September, up from 0.5% in the 12 months to August.

Gloom deepened among **euro-area** firms. The Ifo index of western German business sentiment dropped for the fifth month running. Although companies' evaluation of current conditions improved, their expectations worsened. The INSEE indicator of French business confidence also declined. Italian consumer-price inflation edged up to 2.7% in October. In the same month, German inflation also rose, to 1.2%. The euro area's current-account surplus widened to $31.6 billion in the year to August.

The **euro area's** broad-money supply growth accelerated, from 7.0% in August to 7.4% in September, thanks partly to switching by investors from equities into money-market funds and other cash assets.

Sweden's trade surplus narrowed slightly to $14.3 billion in the 12 months to September.

In the year to the third quarter, **Britain's** economy grew by 1.7% , the strongest annual growth rate for a year and a healthy rise from the 1.3% growth in the year to the second quarter. Renewed strength in manufacturing, which had flagged in recent quarters, along with still-surging services, contributed to the overall rise in output.

Although **Japan's** industrial production fell by 0.3% in September, it rose by 4.9% in the 12 months to September, marking a strong increase over the 1.8% growth in the year to August. Unemployment decreased slightly from 5.5% in August to 5.4% in September, though it remains near its post-war high. Consumer prices in Japan are still falling year-on-year: the deflation rate was 0.7% in September.

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Output, demand and jobs

Oct 31st 2002
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 2.4	+ 3.8 Q2	+ 3.8	+ 3.5	+ 2.7 Q2	+ 6.3 Q2	6.2 Sep	6.7
Austria	na	+ 0.4 Q2	+ 0.7	+ 1.9	– 1.4 Aug	+ 2.7 Jul	4.2 Aug	3.6
Belgium	+ 1.2	+ 0.3 Q2	+ 0.6	+ 2.0	+ 2.8 Aug	+ 3.5 Jul	12.0 Sep†	11.7
Britain	+ 2.7	+ 1.7 Q3	+ 1.6	+ 2.7	– 3.5 Aug	+ 4.6 Sep	5.2 Aug‡	5.1
Canada	+ 4.3	+ 3.2 Q2	+ 3.3	+ 3.3	+ 3.3 Jul	+ 5.4 Jul	7.7 Sep	7.2
Denmark	+ 4.4	+ 2.0 Q2	+ 1.7	+ 2.1	– 3.2 Aug	+ 3.4 Aug	5.1 Aug	5.1
France	+ 1.6	+ 1.0 Q2	+ 1.1	+ 2.2	– 1.1 Aug	– 1.5 Sep	9.0 Sep††	8.7
Germany	+ 1.1	+ 0.1 Q2	+ 0.4	+ 1.6	– 1.4 Aug	– 2.2 Aug	9.8 Sep§	9.4
Italy	+ 0.9	+ 0.2 Q2	+ 0.5	+ 1.9	– 7.0 Aug	– 1.4 Aug	9.0 Jul	9.5
Japan	+ 2.6	– 0.7 Q2	– 0.7	+ 1.0	+ 4.9 Sep	– 1.3 Aug	5.4 Sep	5.3
Netherlands	+ 0.5	nil Q2	+ 0.6	+ 1.8	– 2.0 Aug	+ 2.0 Aug	2.3 Sep**	2.0
Spain	+ 1.8	+ 2.0 Q2	+ 1.9	+ 2.6	– 3.9 Aug	na	11.3 Aug	10.6
Sweden	+ 2.4	+ 2.1 Q2	+ 1.8	+ 2.6	– 0.4 Aug	+ 2.1 Aug	4.2 Sep†	4.0
Switzerland	+ 0.4	– 0.4 Q2	+ 0.3	+ 1.6	– 2.0 Q2	– 0.6 Aug	2.8 Sep†	1.7
United States	+ 1.3	+ 2.2 Q2	+ 2.4	+ 2.8	+ 1.5 Sep	+ 6.1 Aug	5.6 Sep	5.0
Euro area	+ 1.6	+ 0.7 Q2	+ 0.8	+ 2.0	– 0.8 Aug	+ 1.4 Jul	8.3 Aug	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 8.8	+ 2.5 Q2	na	na	+ 0.8 Sep	+ 1.2 Jul	8.1 Sep†	8.7
Greece	na	+ 4.0 Q2	na	na	+ 1.5 Aug	na	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.2 Aug†	1.1
Ireland	na	+ 2.9 Q1	na	na	+ 9.4 Aug	+ 1.2 Aug	4.3 Sep	3.8
Luxembourg	na	+ 3.52001	na	na	+ 0.6 Jul	– 6.3 May	2.8 Aug†	2.4
New Zealand	+ 7.1	+ 4.0 Q2	na	na	+ 4.3 Q2	+ 8.3 Q2	5.1 Q2	5.3
Norway	+ 3.1	+ 1.7 Q2	na	na	+ 1.5 Aug	+ 4.3 Sep	3.8 Q2	3.6
Portugal	+ 2.8	+ 0.9 Q2	na	na	+ 0.1 Sep	+ 1.9 Aug	4.5 Q2†	3.9

*% change at an annual rate. †Not seasonally adjusted. ‡June–Aug; claimant count rate 3.1% in Sep. §EU harmonised rate 8.3% in Sep. **Jul-Sep. ††Revised series.

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Prices and wages

Oct 31st 2002
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.2	Q3	+ 2.5	+ 2.8	+ 2.5	– 0.2	Q3	+ 2.4	+ 3.7	Q2	+ 4.4
Austria	+ 1.6	Sep	+ 2.6	+ 1.7	+ 1.7	– 0.1	Sep	+ 0.1	+ 2.3	Sep	+ 2.9
Belgium	+ 1.3	Oct	+ 2.4	+ 1.6	+ 1.5	+ 0.8	Sep	– 1.0	+ 2.1	Q3	+ 3.7
Britain	+ 1.7	Sep	+ 1.7	+ 1.9	+ 2.4	+ 0.4	Sep	– 0.2	+ 3.8	Aug	+ 4.5
Canada	+ 2.3	Sep	+ 2.6	+ 2.0	+ 2.5	+ 0.5	Sep	+ 1.0	+ 3.0	Jul	+ 1.6
Denmark	+ 2.4	Sep	+ 2.3	+ 2.3	+ 2.0	– 0.3	Sep	+ 0.7	+ 3.7	Q2	+ 4.7
France	+ 1.8	Sep	+ 1.5	+ 1.8	+ 1.4	+ 0.3	Sep	– 0.2	+ 3.8	Q2	+ 4.2
Germany	+ 1.2	Oct	+ 2.0	+ 1.4	+ 1.1	+ 0.3	Sep	– 0.2	+ 2.7	Aug	+ 1.9
Italy	+ 2.7	Oct	+ 2.5	+ 2.4	+ 1.9	+ 0.5	Sep	+ 0.4	+ 2.5	Aug	+ 2.5
Japan	– 0.7	Sep	– 0.8	– 0.9	– 0.6	– 0.4	Sep	– 0.3	– 3.4	Aug	– 1.3
Netherlands	+ 3.4	Sep	+ 4.7	+ 3.7	+ 2.4	+ 0.2	Aug	+ 1.8	+ 3.1	Aug	+ 5.0
Spain	+ 3.5	Sep	+ 3.4	+ 3.3	+ 2.6	+ 0.8	Aug	+ 1.6	+ 4.0	Q2	+ 2.9
Sweden	+ 1.9	Sep	+ 3.2	+ 2.3	+ 2.0	– 0.3	Sep	+ 1.1	+ 2.3	Jul	+ 2.6
Switzerland	+ 1.3	Oct	+ 0.6	+ 0.7	+ 1.0	– 1.2	Sep	– 0.9	+ 2.5	2001	+ 1.3
United States	+ 1.5	Sep	+ 2.6	+ 1.6	+ 2.2	– 1.9	Sep	+ 1.6	+ 3.0	Sep	+ 4.1
Euro area	+ 2.1	Sep	+ 2.2	+ 2.2	+ 1.6	– 0.2	Aug	+ 1.7	+ 3.3	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Sep	+ 2.4	na	na	– 0.8	Sep	– 2.1	+ 3.8	Q2	+ 4.9
Greece	+ 3.5	Sep	+ 3.6	na	na	+ 2.1	Aug	+ 2.1	na		na
Iceland	+ 2.9	Oct	+ 8.0	na	na	+ 5.9	Oct	+ 6.8	+ 5.8	Sep	+ 9.1
Ireland	+ 4.5	Sep	+ 4.6	na	na	+ 0.3	Sep	– 0.3	+ 4.3	Q2	+ 8.5
Luxembourg	+ 2.0	Sep	+ 2.4	na	na	– 0.3	Aug	– 0.4	– 1.7	Jul	+ 5.7
New Zealand	+ 2.6	Q3	+ 2.4	na	na	+ 1.5	Q2	+ 8.1	+ 2.1	Q2	+ 1.8
Norway	+ 1.4	Sep	+ 2.4	na	na	– 5.0	Sep	–11.0	+ 4.9	Q2	+ 4.4
Portugal	+ 3.7	Sep	+ 4.0	na	na	– 1.8	Aug	– 0.2	– 0.2	Jun	– 0.6

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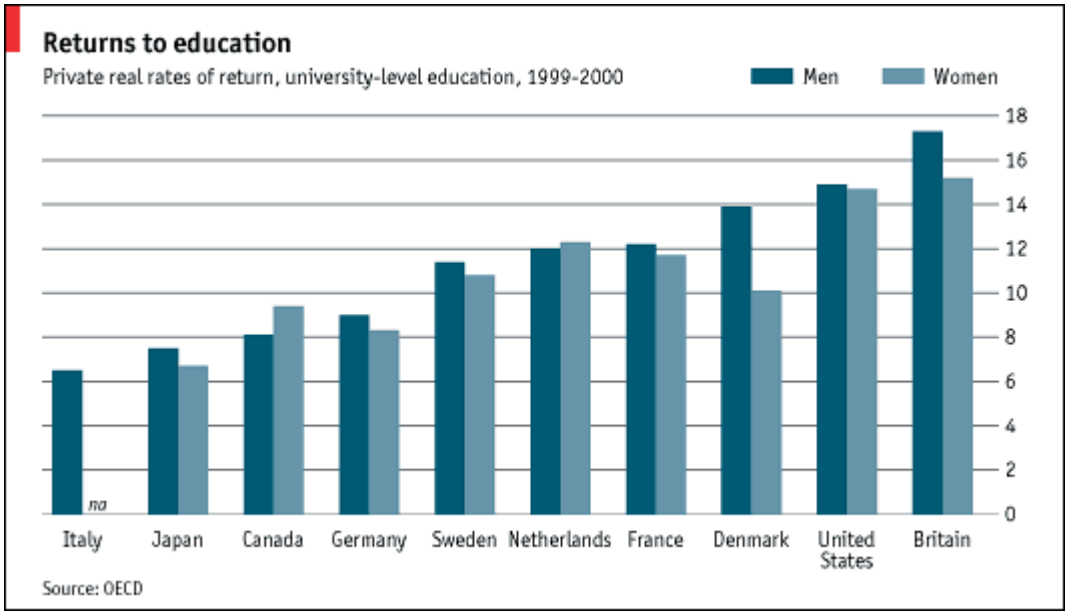
Returns to education

Oct 31st 2002
From The Economist print edition



University education is the best investment most people can make. The OECD's new estimates of the annual returns to successful students range from 6.5% in Italy to 17.3% in Britain. The calculation treats the costs of study, including earnings forgone, as the investment; and the gains in post-tax earnings above those of school-leavers as the pay-off. Shorter university courses are one reason why returns are so high in Britain.

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Money and interest rates

Oct 31st 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 30th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 4.2	+ 8.8	Aug	4.86	4.27	4.81	5.64	5.21	6.80
Britain	+ 8.2	+ 5.4	Sep	3.91	4.13	3.64	4.59	4.47	5.85
Canada	+14.7	+ 6.6	Sep	2.75	2.37	3.36	5.18	4.90	7.32
Denmark	+ 7.4	+ 8.1	Sep	3.47	3.95	3.54	4.71	4.59	6.86
Japan	+29.7	+ 3.3	Sep	0.02	0.01	0.00	1.03	1.31	1.11
Sweden	+ 2.4	+ 4.0	Jun	4.09	3.66	4.13	5.06	4.86	4.80
Switzerland	+12.3	+ 6.8	Sep	0.74	2.09	0.95	2.60	2.87	3.92
United States	– 0.6	+ 6.5	Sep	1.62	2.14	1.71	3.96	4.27	6.58
Euro area†	+ 8.2	+ 7.4	Sep	3.25	3.52	3.11	4.50	4.34	5.43

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.02%, Japan No.243 1.03%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 31st 2002
From The Economist print edition

1995=100

	Oct 22nd	Oct 29th*	% change on one month	% change on one year
Dollar index				
All items	75.4	75.5	+ 1.3	+19.9
Food	80.3	80.1	+ 0.8	+21.3
Industrials				
All	68.9	69.2	+ 2.1	+17.8
Nfa†	71.1	71.1	– 0.8	+27.6
Metals	67.0	67.7	+ 5.0	+10.3
Sterling index				
All items	76.9	76.4	+ 2.0	+12.0
Euro index				
All items	101.5	100.8	+ 1.3	+10.6
Yen index				
All items	100.4	98.4	+ 1.2	+20.8
Gold				
$ per oz	312.85	317.25	– 1.3	+13.2
West Texas Intermediate				
$ per barrel	27.87	26.72	–13.2	+22.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 31st 2002
From The Economist print edition

Market indices

	Oct 30th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,960.0	3,440.0	2,855.5	− 0.9	−14.0	−11.9	− 5.0
Austria (ATX)	1,062.5	1,357.2	1,003.7	+ 0.9	−38.8	− 6.8	+ 2.9
Belgium (Bel 20)	1,956.3	2,899.8	1,773.7	− 1.7	−46.9	−29.7	−22.3
Britain (FTSE 100)	4,002.7	5,323.8	3,671.1	− 0.1	−42.2	−23.3	−17.9
Canada (Toronto Composite)	6,330.4	7,958.1	5,695.3	− 0.1	−44.4	−17.7	−16.1
Denmark (KBX)	166.3	233.4	156.4	+ 0.3	−44.9	−26.0	−18.3
France (SBF 250)	2,069.6	3,081.9	1,794.5	+ 2.9	−52.9	−30.6	−23.3
(CAC 40)	3,084.2	4,688.0	2,656.5	+ 3.1	−55.4	−33.3	−26.3
Germany (Xetra DAX)	3,113.6	5,462.6	2,597.9	+ 3.3	−61.4	−39.7	−33.3
Italy (BCI)	1,072.0	1,513.0	974.4	− 0.5	−50.9	−25.2	−17.4
Japan (Nikkei 225)	8,756.6	11,979.9	8,439.6	+ 0.5	−77.5	−16.9	−11.4
(Topix)	870.2	1,139.4	835.6	+ 0.5	−69.8	−15.7	−10.0
Netherlands (AEX)	335.1	531.2	291.4	+ 1.7	−52.2	−33.9	−27.0
Spain (Madrid SE)	632.8	848.1	568.5	+ 1.9	−44.8	−23.2	−15.2
Sweden (Affarsvarlden Gen)	144.4	236.8	122.7	+ 3.4	−63.9	−37.6	−29.0
Switzerland (Swiss Market)	4,886.0	6,694.1	4,435.0	+ 2.6	−41.9	−23.9	−15.1
United States (DJIA)	8,427.4	10,635.3	7,286.8	− 0.8	−28.1	−15.9	−15.9
(S&P 500)	890.7	1,172.5	776.8	− 0.6	−41.7	−22.4	−22.4
(NASDAQ Comp)	1,326.7	2,059.4	1,114.1	+ 0.5	−73.7	−32.0	−32.0
Europe (FTSE Eurotop 300)*	886.5	1,279.7	797.2	+ 1.5	−48.0	−29.7	−22.3
Euro area (FTSE Ebloc 100)*	737.7	1,125.1	639.4	+ 2.7	−52.4	−33.7	−26.7
World (MSCI)†	786.8	1,024.4	703.7	− 0.4	−45.7	na	−21.6
World bond market (Salomon)‡	496.4	504.2	430.3	+ 1.2	− 1.5	na	+12.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 31st 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† 1990=100 Oct 30th	year ago	Currency units per $ Oct 30th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	− 2.7	Sep	− 11.6	Q2	− 3.7	− 3.8	74.1	70.5	1.81	1.98	2.82	1.78	1.48	0.1
Austria	− 1.1	Jul	− 1.0	Aug	− 1.6	− 1.7	100.8§	100.2	1.02	1.11	1.58	–	0.83	-0.3
Belgium	+ 16.6	Aug	+ 12.5	Jun	+ 5.0	+ 5.1	100.1§	99.0	1.02	1.11	1.58	–	0.83	nil
Britain	− 44.2	Aug	− 25.8	Q2	− 2.1	− 2.0	106.4	106.5	0.64	0.69	–	0.63	0.52	-0.8
Canada	+ 34.3	Aug	+ 12.1	Q2	+ 2.0	+ 2.2	75.9	75.7	1.57	1.59	2.44	1.54	1.28	1.0
Denmark	+ 7.3	Aug	+ 3.5	Aug	+ 2.2	+ 2.0	102.9	102.6	7.56	8.27	11.8	7.43	6.15	2.2
France	+ 9.7	Aug	+ 27.6	Aug	+ 1.7	+ 1.6	103.0§	101.6	1.02	1.11	1.58	–	0.83	-2.0
Germany	+106.6	Aug	+ 31.9	Aug	+ 1.4	+ 1.1	99.9§	98.6	1.02	1.11	1.58	–	0.83	-2.8
Italy	+ 10.6	Jul	− 3.1	Jul	nil	− 0.1	73.4§	72.5	1.02	1.11	1.58	–	0.83	-1.4
Japan	+ 86.5	Aug	+114.0	Aug	+ 2.8	+ 2.8	131.7	137.4	123	122	191	121	–	-8.0
Netherlands	+ 26.0	Aug	+ 2.7	Q2	+ 3.5	+ 3.6	99.1§	98.0	1.02	1.11	1.58	–	0.83	0.1
Spain	− 36.4	Aug	− 14.5	Jul	− 1.9	− 1.6	75.0§	74.2	1.02	1.11	1.58	–	0.83	-0.3
Sweden	+ 14.3	Sep	+ 7.9	Aug	+ 3.3	+ 3.4	78.1	73.0	9.22	10.6	14.4	9.07	7.51	2.1
Switzerland	+ 3.8	Sep	+ 22.7	Q2	+10.1	+10.3	114.5	112.3	1.49	1.63	2.32	1.46	1.21	na
United States	−446.5	Aug	−428.8	Q2	− 4.7	− 4.9	114.3	119.1	–	–	1.56	0.98	0.81	-1.0
Euro area	+ 89.5	Aug	+ 31.6	Aug	+ 0.5	+ 0.6	81.8	78.9	1.02	1.11	1.58	–	0.83	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.0	Aug	+ 9.4	Aug	na	na	79.2§	78.4	1.02	1.11	1.59	–	0.83	3.2
Greece	− 18.4	Jul	− 7.8	Jul	na	na	58.0§	57.5	1.02	1.11	1.59	–	0.83	0.4
Iceland	+ 0.2	Aug	− 0.1	Q2	na	na	91.8**	84.5	88.8	104.6	138	87.3	72.3	-0.5
Ireland	+ 34.2	Aug	+ 0.4	Q2	na	na	89.3§	87.6	1.02	1.11	1.59	–	0.83	0.1
Luxembourg	− 2.9	Jul	+ 2.1	Q2	na	na	100.1§	99.1	1.02	1.11	1.59	–	0.83	2.2
New Zealand	− 0.2	Sep	− 1.3	Q2	na	na	88.3	78.7	2.08	2.42	3.24	2.05	1.69	0.1
Norway	+ 24.5	Sep	+ 25.6	Aug	na	na	105.2	96.4	7.50	8.88	11.7	7.38	6.11	14.0
Portugal	− 12.8	Jul	− 9.4	Jul	na	na	91.0**	89.3	1.02	1.11	1.59	–	0.83	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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Cocoa

Oct 31st 2002
From The Economist print edition

Cocoa prices soared to 17-year highs in mid-October, owing to violence in Côte d'Ivoire. A subsequent ceasefire then caused the biggest one-day drop in over a decade.

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Overview

Oct 31st 2002
From The Economist print edition

Financial markets reacted calmly to Luiz Inacio Lula da Silva's victory in **Brazil's** presidential election run-off on October 27th. The stockmarket rose and the *real* strengthened slightly over the week. In September, the country's current account recorded its second monthly surplus in a row.

In the 12 months to September, **South Korea's** industrial production rose by 3.4%, but its current-account surplus fell again.

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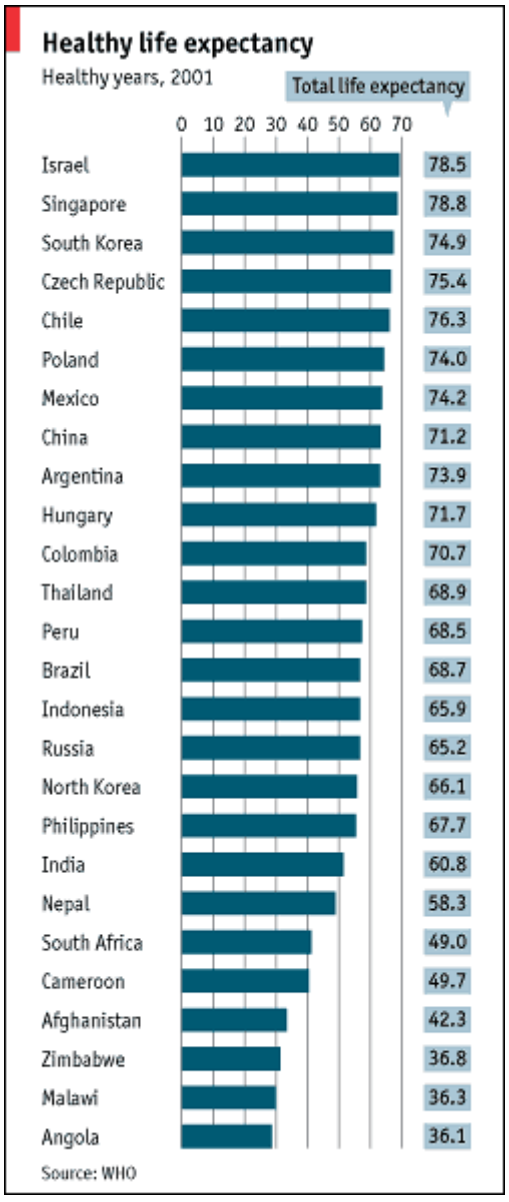
Healthy life expectancy

Oct 31st 2002
From The Economist print edition

In a new report, the World Health Organisation (WHO) estimates that 40% of the world's 56m deaths last year were caused by such preventable risks as unsafe sex, high blood pressure and cholesterol levels, obesity, tobacco and alcohol consumption, indoor smoke from solid fuels, poor sanitation, iron deficiency and child malnutrition. Hardest-hit are the countries of sub-Saharan Africa. According to the WHO, reducing these risks could add, on average, five years of good health to people in rich countries, and more than a decade to people in the developing world.



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Economy

Oct 31st 2002
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q3	+13.8	Sep	– 0.7	Sep	+29.1	Sep	+17.4	2001	258.6	Sep
Hong Kong	+ 0.5	Q2	–11.2	Q2	– 3.7	Sep	– 7.6	Sep	+15.7	Q2	111.2	Sep
India	+ 6.0	Q2	+ 5.7	Aug	+ 3.9	Aug	– 5.1	Aug	+ 2.0	Q2	59.5	Sep
Indonesia	+ 3.5	Q2	–13.8	Q1	+10.1	Sep	+26.6	Aug	+ 6.1	Q1	29.3	Aug
Malaysia	+ 3.8	Q2	+ 5.9	Aug	+ 2.1	Sep	+12.8	Aug	+ 6.9	Q2	33.0	Aug
Philippines	+ 4.5	Q2	–12.0	Aug	+ 2.9	Sep	+ 2.6	Aug	+ 6.1	Jul	13.2	Sep
Singapore	+ 3.7	Q3	+10.4	Sep	– 0.4	Sep	+ 7.5	Sep	+17.5	Q2	80.7	Sep
South Korea	+ 6.3	Q2	+ 3.4	Sep	+ 2.8	Oct	+ 9.9	Sep	+ 5.2	Sep	116.0	Sep
Taiwan	+ 3.0	Q2	+12.5	Sep	– 0.7	Sep	+18.2	Sep	+24.8	Q2	156.4	Aug
Thailand	+ 5.1	Q2	+ 9.8	Sep	+ 0.4	Sep	+ 3.8	Sep	+ 6.9	Sep	37.7	Aug
Argentina	–13.6	Q2	– 3.5	Sep	+38.5	Sep	+14.1	Aug	+ 3.9	Q2	9.2	Aug
Brazil	+ 1.0	Q2	+ 0.9	Aug	+ 7.9	Sep	+ 9.9	Sep	–13.1	Sep	37.6	Aug
Chile	+ 1.7	Q2	+ 5.2	Sep	+ 2.3	Sep	+ 2.2	Sep	– 0.6	Q2	14.9	Aug
Colombia	+ 2.2	Q2	+ 2.7	Jul	+ 6.0	Sep	+ 0.5	Jul	– 1.4	Q1	10.6	Sep
Mexico	+ 2.1	Q2	+ 0.7	Aug	+ 5.0	Sep	– 8.9	Sep	–16.3	Q2	46.5	Aug
Peru	+ 3.8	Aug	+ 4.8	Aug	+ 0.7	Sep	+ 0.2	Aug	– 1.0	Q2	9.3	Sep
Venezuela	– 9.9	Q2	– 6.6	Jul	+28.2	Sep	+ 8.5	Q2	+ 1.9	Q2	8.2	Jul
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.7	Aug	– 7.9	Jul	nil	Q2	13.0	Jun
Israel	– 1.7	Q2	– 2.8	Aug	+ 6.4	Sep	– 6.2	Sep	– 2.6	Q2	24.6	Sep
South Africa	+ 2.2	Q2	+ 8.2	Aug	+12.5	Sep	+ 3.4	Aug	– 0.3	Q2	5.9	Sep
Turkey	+ 8.2	Q2	+ 7.2	Aug	+37.0	Sep	–11.4	Aug	+ 1.5	Jul	25.1	Sep
Czech Republic	+ 2.5	Q2	– 2.8	Aug	+ 0.8	Sep	– 3.1	Sep	– 2.3	Q2	22.3	Sep
Hungary	+ 3.1	Q2	– 0.9	Aug	+ 4.6	Sep	– 2.6	Aug	– 2.4	Aug	10.1	Sep
Poland	+ 0.8	Q2	+ 6.7	Sep	+ 1.3	Sep	–10.3	Aug	– 6.4	Aug	28.2	Sep
Russia	+ 4.1	Q2	+ 5.5	Sep	+15.0	Sep	+42.6	Aug	+28.3	Q2	41.9	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 2.8	May	+ 3.7	Sep	– 1.1	Sep	+ 2.7	2002†	4.8	Jun
Saudi Arabia	+ 1.2	2001	na		– 0.2	Apr	+44.1	2001	+14.5	2001	17.7	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; Russian Economic Trends.

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Financial markets

Oct 31st 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 30th		Dec 31st 2001	
	Oct 30th	year ago	Oct 30th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.9	na	1,577.3	– 2.5	– 7.9	– 7.9
Hong Kong	7.80	7.80	12.1	1.93	9,560.5	– 2.5	– 16.1	– 16.1
India	48.4	48.0	75.3	5.72	2,888.6	– 2.0	– 11.5	– 11.7
Indonesia	9,227	10,475	14,370	13.90	361.1	+ 1.8	– 7.9	+ 3.8
Malaysia	3.80	3.80	5.92	3.10	657.7	+ 0.8	– 5.5	– 5.5
Philippines	53.1	52.0	82.7	6.63	1,048.5	+ 3.5	– 10.2	– 12.8
Singapore	1.77	1.82	2.76	1.13	1,459.0	– 0.3	– 10.1	– 6.3
South Korea	1,233	1,291	1,919	4.94	658.0	+ 0.1	– 5.1	+ 1.1
Taiwan	34.8	34.5	54.1	2.10	4,498.7	– 2.0	– 19.0	– 18.4
Thailand	43.4	44.7	67.6	1.94	355.0	+ 2.5	+ 16.8	+ 19.1
Argentina	3.56	1.00	5.54	16.80	430.8	– 0.7	+ 45.9	– 59.0
Brazil	3.73	2.69	5.81	20.90	10,068.6	+ 2.3	– 25.8	– 54.1
Chile	733	710	1,142	2.76	4,733.0	+ 1.1	– 12.3	– 20.9
Colombia	2,775	2,308	4,322	7.97	1,377.0	+ 3.6	+ 28.6	+ 5.5
Mexico	10.22	9.25	15.9	7.54	5,963.8	– 0.6	– 6.4	– 16.0
Peru	3.61	3.44	5.62	3.94	1,217.3	+ 1.5	+ 3.6	– 1.1
Venezuela	1,395	744	2,173	33.08	7,681.4	– 1.2	+ 16.9	– 36.5
Egypt	4.65	4.26	7.23	6.59	5,217.7	+ 0.1	– 1.0	– 2.5
Israel	4.77	4.28	7.43	6.40	328.0	– 0.2	– 26.6	– 32.1
South Africa	10.1	9.43	15.7	13.65	9,330.6	– 4.0	– 10.6	+ 6.3
Turkey	1,676,500	1,593,500	2,610,981	42.00	10,138.5	+ 2.0	– 26.4	– 36.2
Czech Republic	31.4	37.3	48.9	2.75	423.6	– 2.1	+ 7.3	+ 21.6
Hungary	246	283	382	9.70	7,335.9	+ 1.9	+ 2.9	+ 15.1
Poland	4.05	4.09	6.31	7.09	14,042.5	+ 2.2	+ 0.9	– 1.6
Russia	31.8	29.7	49.5	21.00	352.7‡	– 1.3	+ 41.2	+ 35.6
EMF (MSCI)*	1.00	1.00	1.56	na	279.4	– 0.2	na	– 15.0
EMBI+†	1.00	1.00	1.56	na	213.1	+ 2.0	na	+ 6.4

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends.*

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